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SUBJECT:

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Remarks


Executive Secretary

4 Feb '88

Date

3637 (10-81)

Confidential Attachment

**THE WHITE HOUSE
WASHINGTON**

Executive Registry

88-0384X

CABINET AFFAIRS STAFFING MEMORANDUM

Date: Feb. 2, 1988 **Number:** 490,725 **Due By:** -----

Subject: Economic Policy Council Minutes

	Action	FYI		Action	FYI
ALL CABINET MEMBERS	<input type="checkbox"/>	<input type="checkbox"/>	CEQ	<input type="checkbox"/>	<input type="checkbox"/>
Vice President	<input type="checkbox"/>	<input checked="" type="checkbox"/>	OSTP	<input type="checkbox"/>	<input type="checkbox"/>
State	<input type="checkbox"/>	<input checked="" type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
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VA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS:

The minutes from the Economic Policy Council meetings held on September 10, 15, 16, and 17, 1987 are attached for your information.

RETURN TO:

☒ Nancy J. Risque
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Associate Director
Office of Cabinet Affairs
456-2800
(Room 235, OE08)

DCI
EXEC
REG

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~~CONFIDENTIAL~~

MINUTES
ECONOMIC POLICY COUNCIL

September 10, 1987

11:00 a.m.

Roosevelt Room

Attendees: Messrs. Baker, Brock, Miller, Yeutter, Sprinkel, Smart, Whitehead, Taft, Burns, Myers, Burnley, Martin, Cribb, Bauer, McAllister, Crippen, Danzansky, Dyer, Gibson, Greenleaf, Hoffman, McPherson, Murphy, and Stephens, and Ms. Risque, Ms. King, Ms. Range, and Ms. Arsht.

1. Canada FTA

Mr. Murphy stated that the negotiations with Canada for a Free Trade Agreement (FTA) have stalled, mainly because of a failure to make progress in the dispute settlement mechanism and subsidies areas. He suggested that the United States make a further offer in dispute settlement, but at the same time impress upon the Canadians that they must place greater discipline on their subsidies. He cautioned that if the Administration goes too far by establishing a dispute settlement mechanism not based on U.S. law, Congress may reject the entire FTA.

The Council's discussion focused on the need to respond to the Canadian request for more flexibility on dispute settlement; the importance of reciprocal Canadian action on subsidies; and the appropriate timing for any action on dispute settlement.

Mr. Murphy also described the progress we are making in other areas of the FTA, such as autos, services, and investment.

The Council also discussed several alternative formulations for a new dispute settlement mechanism proposal. Secretary Baker emphasized the importance of stating that the United States has offered a second proposal on dispute settlement.

2. Outstanding Section 301 Cases

Ambassador Yeutter reviewed the status of several outstanding or potential Section 301 cases. He explained that on January 1, 1988, EC regulations forbidding the use of stimulants in beef products will go into effect. He stated that the United States has taken these regulations to the GATT arguing that there is no scientific basis for the regulations. He suggested that the Administration pursue the following approach: communicate to the

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September 10, 1987
Page Two

EC that they must either agree to establish a scientific panel on the issue or extend the implementation date, or the United States will self-initiate a Section 301 case. Mr. Myers agreed that if the EC action takes effect, it would be a severe shock to the U.S. industry and urged that we act soon. Secretary Baker suggested that before we take action we discuss the issue with Senators from meat exporting states.

Ambassador Yeutter noted that we are not making the necessary progress in opening up Kansai Airport and other major Japanese construction projects to U.S. bidders. He stated that both trade bills require the United States to take a Section 301 case against the Japanese. He pointed out that Prime Minister Nakasone, who earlier made a personal pledge to resolve the issue, will be in the United States in late September.

Ambassador Yeutter suggested this would be a good opportunity to raise the ante on this issue. Mr. Smart noted that construction is a highly political issue for Japan.

Mr. Whitehead suggested that a Section 301 case would not be productive, arguing that there are not many U.S. construction firms interested in the Japanese market. Mr. Smart noted that U.S. firms are looking for design and specification contracts, which would also help open markets for U.S. equipment manufacturers.

Secretary Baker, noting that the trade bill conference is not likely to get started before October 1, suggested that we take advantage of this time to urge Prime Minister Nakasone to take strong measures in opening up the market for U.S. construction firms.

3. Telecommunications

Ambassador Yeutter summarized the potential for a Section 301 case on telecommunications. He noted that the GATT procurement code does not require open telecommunications markets. He explained that we could take a case outside the GATT process or make the case for telecommunications being a service, a somewhat more difficult proposition. He stated that there is language in both House and Senate trade bills calling for Section 301 action on telecommunications. Ambassador Yeutter noted that our best case for a Section 301 case would be against Germany, which would be an extremely difficult case.

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September 10, 1987
Page Three

Mr. Whitehead cautioned against a "generic" Section 301 case that would apply to a number of countries at the same time. He noted that the United States has only recently opened its market, and that many countries are beginning to consider breaking up their monopolies. He also noted that the U.S. telecommunications industry is against any Section 301 cases.

Ambassador Yeutter stated that he would not recommend a Section 301 case at this time. The Council agreed.

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MINUTES
ECONOMIC POLICY COUNCIL

September 15, 1987
3:00 p.m.
Roosevelt Room

Attendees: Messrs. Baker, Brock, Miller, Yeutter, Smart, Myers, Burnley, Martin, Carlucci, Cribb, Bauer, McAllister, Crippen, Danzansky, Gibson, Greenleaf, Holmer, Hoffman, McMinn, McPherson, Stephens, Stucky, and Woods, and Ms. Risque, Ms. King, and Ms. Turner.

1. Trade Legislation

Secretary Baker asked that each of the four subcommittees report on their efforts. He explained that the Banking Subcommittee, which he chaired, tried to accomplish three goals at its first meeting: (1) assess whether developing compromise language would help or hurt the Administration's objectives; (2) identify outside groups with an interest in the issues; and (3) agree upon a tentative opening position on many of the issues. He noted that some of the banking issues in the trade bills that warrant significant opposition include: (1) the Foreign Agricultural Investment Reform (FAIR) provisions; (2) MIGA proposal; (3) Representative Shumer's "options menu"; (4) the international debt facility; (5) the House exchange rate requirements; (6) primary dealer reciprocity; and (7) Representatives Bryant and Florio's investment screening provisions.

Secretary Brock reported that the Commerce, Labor, and Government Operations Subcommittee agreed upon the appropriate Administration position on the issues and focused on establishing priorities. He noted that in the areas reviewed by his subcommittee, most of the Administration comments would be negative. He pointed out that it is very important for the Administration to make sure that the Worker Adjustment Program and the Trade Adjustment Assistance program are considered at the same time.

Ambassador Yeutter stated that the Trade Subcommittee spent its time establishing a preference for either the Senate or House formulation or identifying provisions in which both House and Senate formulations are unacceptable. He also pointed out that there are instances in which one bill contains an objectionable provision and the other bill is silent.

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Minutes
Economic Policy Council
September 15, 1987
Page Two

The Council discussed the wisdom of sending separate letters dealing with the Subcommittee issues. Secretary Baker suggested that any letter that is sent must fit into our larger strategy on the trade bill.

Mr. Myers reported that the Agriculture Subcommittee had agreed that the Administration should oppose all of the agricultural provisions except two: MTN authority and automatic marketing loans. He explained that the Subcommittee would do more work in identifying priorities and interest groups that could support our position. Mr. Woods urged that the Administration should get the private sector involved early, which would be especially helpful in informing Congress of the practical consequences of some of the well-intentioned provisions. Mr. Burnley suggested that the cargo preference provisions would warrant a veto recommendation.

Secretary Baker asked the White House Office of Public Liaison to draw up a list of interest groups that have a stake in the trade bill. Mr. Woods reported that the Assistant Secretaries for Legislative Affairs have assigned to each Cabinet member specific Senators with whom they should discuss the Administration's concerns about the trade bill. Mr. Woods also cautioned that because the Administration is well organized we may help the Congress get organized if we move too aggressively.

The Council also discussed the importance of the trade balance numbers. Secretary Baker asked Mr. Sprinkel and Mr. Smart to determine if we can issue numbers based on trade volumes, not just value.

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MINUTES
ECONOMIC POLICY COUNCIL

September 16, 1987
11:00 a.m.
Roosevelt Room

Attendees: Messrs. Baker, Miller, Yeutter, Sprinkel, Smart, Whitehead, Myers, Whitfield, Burnley, Martin, Carlucci, Cribb, Bauer, McAllister, Crippen, Danzansky, Dawson, Dyer, Fitzwater, Greenleaf, Hoffman, McPherson, Mulford, Stephens, Stucky, and Tuck, and Ms. Risque and Ms. Range.

1. Canada FTA

Mr. Murphy explained that a working group chaired by the State Department had determined that the United States must offer benefits similar to those extended to Canada under the Free Trade Agreement (FTA) to roughly eight nations with whom we have treaties of Friendship, Commerce, and Navigation (FCN). He noted that these countries did not exercise these rights under the Israel FTA, and we do not expect them to do so under the Canada FTA. Mr. Burnley pointed out that exempting Canada from the Jones Act could create MFN obligations of up to \$1.6 billion. The Council expressed satisfaction that entering the FTA would not create unmanageable demands by other countries for similar benefits.

Mr. Murphy summarized the status of the negotiations with Canada. He noted that the U.S. private sector is interested in helping support an ambitious agreement. He also suggested that Congress will likely support an agreement as long as it does not go too far in establishing a dispute settlement mechanism that may go beyond U.S. trade laws. Mr. Murphy stated that some of the key areas in which the United States is seeking action include: tariffs, investment, financial services, insurance, autos, films, discipline on subsidies, intellectual property, and access to energy.

Mr. Murphy briefly described the dispute settlement proposal he put on the table, explaining that he made it clear to the Canadians that the Economic Policy Council had not yet considered the proposal. Mr. Smart stated that the Commerce Department supports Mr. Murphy's idea. Mr. Murphy explained that the Canadians place considerable weight on the dispute settlement proposal because they believe U.S. trade laws are capricious and

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Page Two

biased against them. The Council discussed various aspects of the proposal, including whether the mechanism would be binding and the importance of explicitly excluding the lumber finding from the reach of the mechanism.

Mr. Martin stated that the United States is seeking predictability in pricing and access to Canadian energy. He explained that Canada is seeking access to Alaska North Slope (ANS) oil. He stated that the Canadians also want the ability to export uranium to the United States without restrictions. The Council discussed the possibility of mitigating the opposition to opening up the ANS oil, even partially, by requiring that such exports be carried on U.S. ships. Mr. Burnley expressed concerns about exporting ANS oil under any circumstances, particularly in light of the President's decision to permit exports from Cook Inlet. Mr. Martin emphasized that the United States has the potential to gain a great deal on energy in the FTA. Mr. Burnley expressed reservations that including ANS or maritime issues in the FTA would jeopardize the entire agreement.

The Council discussed the process for transmitting the agreement to Congress as well as the opportunities for consulting with Congress on the more controversial items. Ambassador Yeutter stated that the agreement must be sent to Congress by October 4, 1987.

The Council also discussed the investment aspects of the FTA. Mr. Murphy noted that an agreement on investment would be a milestone in U.S. economic relations and would establish a welcome precedent for the GATT Round. Secretary Baker raised some of the implications of the Canadian practice of screening investment in Canadian firms. He suggested that it would be difficult for the United States to assent to screening of U.S. investment and urged Mr. Murphy to pursue alternatives such as ceasing all screening on some date certain.

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MINUTES
ECONOMIC POLICY COUNCIL

September 17, 1987
2:00 p.m.
Roosevelt Room

Attendees: Messrs. Baker, Lyng, Brock, Wright, Smart, Sprinkel, Burnley, Martin, Smith, Cribb, Bauer, McAllister, Crippen, Danzansky, Darby, Dyer, Greenleaf, McMinn, McPherson, Merkin, Mulford, Murphy, Powell, Stucky, and Whitfield, and Ms. Risque, Ms. Range, and Ms. Eckhart.

1. Canada FTA

Secretary Baker stated that the deadline for notifying Congress of our intent to enter into an agreement with Canada is October 4. He asked that the TPRG develop a paper for the Council and the negotiators outlining: (1) what the United States is achieving; (2) what Canada is achieving; and (3) what issues remain unresolved. He suggested that rather than have the President call Prime Minister Mulroney in the next few days, we wait until we have engaged in more substantive negotiations before making a judgement on whether direct Presidential intervention is needed.

Ambassador Smith stated that the TPRG is presenting several options for covering the Auto Pact in the FTA. He explained that the basic issue is whether we seek to eliminate the Auto Pact or attempt to alter it in a manner that increases U.S. employment and opportunities. Mr. Smith stated that the United States and Canada, while agreeing on eliminating tariffs on auto parts, disagree on the speed with which the tariffs would be eliminated; the United States wants immediate elimination.

Mr. Murphy stated that the Canadians will strongly resist any attempt to eliminate the Auto Pact. The Council discussed the U.S. interest in reshaping the Auto Pact; the Canadian political difficulties in eliminating the auto pact; and possible changes to the Pact that would meet the U.S. interests. Several Council members stressed the importance of making some inroads in the Auto Pact.

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Minutes
Economic Policy Council
September 17, 1987
Page Two

2. Steel Pensions

Secretary Brock stated that the Department of Labor has developed a new approach to the steel industry pension problems. He explained that the ERISA Coordinating Committee had done some work on additional alternative approaches that would not require direct Federal outlays. He stated that some sort of special provisions for the steel industry may be necessary for achieving our larger pension reform proposals in Congress: increasing funding requirements and risk-related premiums.

Secretary Brock suggested that the Administration explore the possibility of signaling to Congress what we might be willing to accept as special exceptions for the steel industry. He outlined four principles for any steel program: it must reduce the Federal Government's ultimate loss; Congress must enact reforms that prevent the Government from becoming a large unsecured creditor to other industries; it must not affect future capacity decisions; and must not alter the intra-industry competitive balance. Mr. Bauer suggested several additional principals regarding budget neutrality.

Mr. Sprinkel expressed opposition toward any special treatment for the steel industry. He offered three objections: the steel industry does not need assistance -- profits are improving; such an action would establish a harmful precedent; and special assistance would be a step in the direction of an industrial policy.

The Council discussed the likelihood of obtaining our pension reform proposals without having to provide special assistance to the steel industry. Secretary Brock emphasized that many in Congress have already drawn such a linkage. Secretary Baker summarized the discussion by suggesting that Secretary Brock discuss pension reforms with the steel industry based on the principles cited earlier. He stated that these discussions should not commit the Administration to providing Federal funds.

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Remarks

H/S
Executive Secretary
9 Sept '87

Date

3637 (10-81)

CONFIDENTIAL ATTACHMENTS

**THE WHITE HOUSE
WASHINGTON**

Executive Registry

87-4221X/1

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 9/8/87 **Number:** 490,689 **Due By:** _____

Subject: Economic Policy Council Meeting -- September 10, 1987 -
11:00 a.m. in the Roosevelt Room

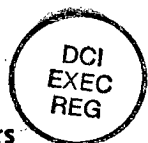
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REMARKS: The papers and revised agenda for the September 10, meeting of the Economic Policy Council are attached. The meeting is scheduled for 11:00 a.m. in the Roosevelt Room.

RETURN TO:

☒ Nancy J. Risque
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Associate Director
Office of Cabinet Affairs
456-2800
(Room 235, OE0B)



B-504, IR

THE WHITE HOUSE

WASHINGTON

September 8, 1987

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: EUGENE J. McALLISTER *EM*

SUBJECT: Agenda and Papers for the September 10 Meeting

The papers and revised agenda for the September 10 meeting of the Economic Policy Council are attached. The meeting is scheduled for 11:00 a.m. in the Roosevelt Room.

The first agenda item will be a discussion of the U.S.-Canadian FTA. The Council will examine whether in exchange for greater Canadian discipline on subsidies at the Federal and provincial level, the U.S. will commit to explore some possible approaches for increasing the role of binding dispute settlement. A paper prepared by USTR and the Commerce Department is attached.

The second agenda item will be a discussion of whether the Administration should self-initiate a Section 301 case on telecommunications. At a previous meeting, the Council requested that the TPRG undertake a review of the feasibility of self-initiating such a case. A paper outlining the justification for a Section 301 case, as well as potential candidate countries, is attached.

The final agenda item will be a discussion of outstanding Section 301 cases, such as Korean insurance practices. The TPRG has also prepared a paper outlining the possibility of self-initiating a Section 301 case on Kansai airport.

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ECONOMIC POLICY COUNCIL

September 10, 1987

11:00 a.m.

Roosevelt Room

AGENDA

1. Canada FTA
2. Section 301 on Telecommunications
3. Outstanding Section 301 Cases

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UNITED STATES-CANADA FREE TRADE AGREEMENT NEGOTIATIONS:
SUBSIDIES AND THE U.S. COUNTERVAILING DUTY LAW

ISSUE

The subsidies/countervailing duty (CVD) law issue could scuttle the FTA talks with Canada, or lead Congress to reject the FTA.

The U.S. and Canada are far apart. Canada's key FTA demand is to substitute agreed rules enforced by binding dispute settlement for U.S. application of its CVD law to Canada. The U.S. has maintained that we must keep our CVD law, but has offered to address Canada's major CVD law concerns if Canada undertakes credible subsidies discipline.

Given the importance of the issue, our negotiators need EPC guidance on how to proceed.

BACKGROUND

The Economics of Subsidies and CVD Cases

In relation to the real world of Canadian subsidies and U.S. CVD cases, the issue is overblown:

- o The U.S. has only five outstanding CVD orders on Canadian products with a total 1986 import value of \$180 million (see attached chart). The six other cases filed against Canada since 1980 resulted in negative subsidy or injury determinations or withdrawals of U.S. petitions. Two of the cases, however, were on lumber, where a negotiated settlement involving trade of some \$2.7 billion was reached in the Lumber II case.
- o Although Canada has a wide variety of federal and provincial subsidy programs, the subsidy margins have been small. (Under outstanding orders, the highest margin is 5.8%; two cases had margins under 1%.) The exception was a 15% margin we preliminarily found in Lumber II; nearly the entire 15% was due to Canadian pricing of rights to remove trees from government lands ("stumpage programs").
- o Canada's only CVD case against the U.S., a 1986 corn case filed following Lumber II, led to high margins. Few U.S. manufacturing industries, however, would be vulnerable to Canadian CVD cases.

Classified by: Ann Hughes
Declassify on: OADR

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- 2 -

Canadian Political Views

The Canadian Government has made the CVD issue into the primary political FTA issue in Canada.

- o The immense importance of the CVD issue to Canada stems from the lumber cases. In 1983, in Lumber I, the U.S. found that Canadian stumpage programs were not subsidies. In 1986, in Lumber II, the U.S. preliminarily found stumpage countervailable. Lumber II led to a U.S.-Canada agreement under which Canada imposed a 15% lumber export tax and committed to revise stumpage practices in exchange for withdrawal of the case.
- o Because forest-based industries (and resource-based industries generally) are central to Canada's economy, the cases and settlement were highly visible in Canada. The lumber decisions led to a widespread Canadian view that the U.S. uses the CVD law to harass, and interprets and applies its CVD law arbitrarily and inconsistently. Canada also fears that the Congress will legislate protectionist changes in the CVD law, particularly on natural resources.

U.S. Congressional and Private Sector Views

It is impossible now to gauge Congressional flexibility to accept U.S. concessions on the CVD law in an FTA. Considerations:

- o The subsidies/CVD issue is likely to be the major FTA issue for the trade community on the Hill. A misstep by the Administration in giving Canada too much on the CVD law for too little Canadian subsidies discipline could embroil the FTA in the trade bill debate and have serious trade bill consequences. On the other hand, if the talks fail over this issue, some may charge the Administration with lacking the vision and creativity to reach an historic FTA benefitting U.S. industry.
- o U.S. industry's right to invoke, and the U.S. Government's right unilaterally (within broad GATT constraints) to interpret and apply unfair trade laws is sacrosanct to much of the Congress. The Congress is also wary of countries' "commitments" to eliminate subsidies, unless we can enforce the commitments. Senator Bentsen, among others, wants to guard against weakening our CVD position multilaterally.
- o A few members (e.g., Senator Moynihan) have publicly favored the Canadian dispute settlement approach, but most members who have reacted to Canadian demands stress that we cannot give up our CVD law or subject our CVD determinations to a binational tribunal's override.

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- 3 -

- o The Hill will judge any concessions on the CVD law by two measures: (1) how good the whole FTA is for the U.S., and (2) how good the subsidies/CVD deal is by itself. Private sector constituencies for other aspects of the FTA, such as investment, may not counterbalance the unfair trade law constituencies.
- o Lumber, steel, and other industries (especially natural resources) will lobby against the FTA unless it protects their ability to obtain unilateral U.S. CVD decisions, at least until Canadian practices have changed. (The lumber industry sees a third lumber case as its ultimate enforcement tool for the lumber agreement.) The Hill is sensitive to these industries; Senate Finance threatened to withhold authority for the FTA negotiations because of the lumber issue.
- o There is undoubtedly some Congressional flexibility to accept a compromise if it (1) ensures very strong discipline on Canadian subsidies, and (2) maintains unilateral U.S. rights to use the CVD law, at least so long as Canadian subsidies are perceived as a problem.

CANADIAN NEGOTIATING POSITION

Canada seeks "predictability" through substitution of agreed rules enforced by binding dispute settlement for U.S. unilateral interpretation and application of the U.S. CVD law. Under Canada's theory, a joint tribunal would interpret CVD-like principles to decide whether a party had met its subsidies discipline commitments, and could impose sanctions if it had not.

The EPC addressed the dispute settlement issue after the Venice Summit, where Prime Minister Mulroney raised it with President Reagan. The EPC approved a U.S. proposal for binding dispute settlement only in mutually agreed instances. The President wrote to Prime Minister Mulroney endorsing that approach.

Canadian negotiators claim that, in exchange for binding dispute settlement, Canada is prepared to undertake serious discipline on subsidies. To date, however, Canada has offered no real subsidies discipline. Canadian proposals would permit subsidies that would clearly be countervailable under U.S. law. We are pressing them for effective discipline. Canada's negotiating strategy to date has been to press us to say what greater discipline we want over Canadian federal and provincial subsidies, but to reject U.S. proposals if they would not fall equally on our state and federal programs.

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The fundamental flaw in Canada's approach is the notion -- appealing though it may seem on the surface -- that the U.S. and Canada can agree on common rules defining what is a subsidy.

- o "Rules" would only give Canada a handbook on how to subsidize. Canada claims we could base the rules on U.S. CVD concepts. But most U.S. CVD concepts are not susceptible of being distilled into clearcut rules; their interpretation depends on the facts and circumstances of a particular case. Trying to transform these concepts into bright-line tests at (or below, in Canada's proposals) approximately the CVD standard would condone subsidies countervailable under U.S. law.
- o Application of U.S. CVD concepts by a binational tribunal would lead inevitably to interpretations conflicting with those of the U.S. Government, the courts, or the Congress. Such tribunal decisions (binding on the U.S., in Canada's scenario) could seriously weaken the U.S. posture on subsidies multilaterally.

U.S. NEGOTIATING POSITION

U.S. negotiators have proceeded on several assumptions:

- o Meaningful subsidies discipline commitments by Canada are a prerequisite to any concessions on the CVD law. Moreover, subsidies discipline commitments -- although they may have to look symmetrical for the U.S. and Canada -- must bite Canada harder than the U.S. Reasons:
 - The U.S. is willing to accept Canadian CVD cases when we subsidize, and prefers to continue to deal with Canadian subsidies through our CVD law. Consequently, even limited relief from our current CVD practices would be unacceptable to the Hill unless we obtain in return increased discipline over Canadian subsidies.
 - Canadian subsidies frequently are targeted and affect exports to the U.S. Our subsidies usually are generally available and rarely affect trade with Canada. (Canada admits that the only "problem" U.S. subsidies are state incentives to attract major auto sector investments.) U.S. states would lobby against an FTA that limits their subsidies unrelated to Canada.
- o An FTA that is good for the U.S. on other issues, such as investment and intellectual property, is a prerequisite to any concessions on the CVD law.
- o We must maintain our CVD law, unilaterally interpreted, though we can consider some special treatment for Canada in the application of that law.

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CURRENT U.S. OFFER

With these ground rules in mind, the U.S. has made a proposal that would:

- o Keep the CVD law as the enforcement mechanism for subsidies discipline, but
- o In exchange for credible Canadian subsidies discipline, offer significant substantive and procedural concessions:
 - Commitments on how we would apply the CVD law to Canada in key areas: natural resources (the major area of potential disputes), regional subsidies (some currently countervailable subsidies would be allowed), and infrastructure.
 - Procedural changes to eliminate some CVD cases and enhance the likelihood of suspending others without duties.

Although it may be for tactical reasons, the chief Canadian negotiator has rejected this approach and delayed progress in other areas.

FUTURE U.S. NEGOTIATING POSTURE

U.S. negotiators now require guidance from the EPC on the U.S. negotiating posture in the few weeks remaining.

In the view of our negotiators, there are two prerequisites to either of the options below:

- o Increased Canadian subsidies discipline at the federal and provincial levels, with more stringent discipline applying to Canada than to the U.S.
- o Important Canadian concessions on other FTA issues such as investment and intellectual property.

Option I: Maintain the current U.S. negotiating position, improving the offer in minor ways if warranted by Canadian subsidy commitments.

Assessment. U.S. negotiators believe that the U.S. proposal offers significant CVD concessions which, as a practical matter, go a long way toward addressing Canada's major concerns. The U.S. has not offered such concessions to any other country, including Israel. The concessions on natural resources and regional subsidies could arouse Congressional concern, but our negotiators believe these concessions will be acceptable to the Hill if balanced by Canadian subsidies discipline.

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The current U.S. proposal does not, however, provide the political optics Canada seeks and may require. Canadian negotiators are still at the table, despite clear signals from the President and the U.S. negotiators that the U.S. cannot accept binding dispute settlement in lieu of the CVD law. On the other hand, without some U.S. movement toward meeting Canada's political needs, Canada may not be able to agree to a comprehensive FTA and may have to end the talks.

Option II: Explore possible compromise approaches with Canada, involving some immediate or eventual role for binding dispute settlement. Two examples of the outer limits of such approaches are described below.

- o Agreement to the objective of replacing CVD laws between the U.S. and Canada with binding dispute settlement at the end of the ten-year transition period if (1) significant lasting discipline on Canadian domestic subsidies has been demonstrated by then, and (2) the decision on eliminating the CVD law is subject to Congressional approval at that time.

Assessment. Such a commitment in the FTA would not bind the Congress. Any exemption from the CVD law for Canada in ten years would have to be legislated at that time. If Canadian subsidies and CVD disputes had largely disappeared by then, the Congress might agree. If subsidies/CVD cases were still a problem, Congress could refuse.

Given widespread skepticism, however, that Canada will really discipline subsidies, the Congress might balk at a commitment in the FTA that could put pressure on the Congress to give Canada a CVD exemption in ten years. Moreover, the idea that we would ever forego our unilateral CVD rights may be more than the Congress can accept.

Preliminary signals from Canadian negotiators suggest that this kind of commitment to a ten-year objective could solve Canada's political problem in the negotiations. Canada would probably want to reserve the right to withdraw its own commitments in other areas of the FTA, however, if Congress failed to legislate the CVD law away after 10 years.

- o Contemplating a limited role for binding dispute settlement on adherence to specific subsidy discipline commitments, either immediately or before the end of the ten-year transition period.

For example: Require Canada to agree to subsidies discipline beyond that required by our CVD laws. Employ dispute settlement to test whether Canada lives up to its commitments. U.S. CVD law would remain to apply to other practices or breaches of the commitment.

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Assessment. If a threshold dispute settlement test applied a higher standard than the CVD law, the U.S. could gain significant Canadian discipline for little substantive risk that countervailable subsidies would not be subject to CVD cases. It is doubtful that Canada would commit to the necessary discipline level to accept the compromise, but offering it would call Canada's bluff on the level of discipline they are willing to undertake.

On the other hand, the Congress might reject any role for dispute settlement, out of concern that tribunal decisions could bar some CVD cases.

U.S. COUNTERVAILING DUTY ORDERS AGAINST CANADA

<u>Case</u>	<u>Year</u>	<u>Margin</u>	<u>1986 Import Value*</u>
Live Swine	1985	C\$0.0439/lb	56,743,000 (1985)
Raspberries	1985	0.99%	15,588,752
Groundfish	1986	5.82%	44,835,092
OCTG	1986	0.72%	63,227,854
Cut Flowers	1987	1.47%	55,213
			<u>\$180,449,911</u>

* Data are based on TSUSA numbers listed in the orders. The data may overstate the value of affected imports because TSUSA categories include basket items, and because some companies may be excluded from the orders. They may also understate the imports affected, if CVD cases chill trade.

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OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

September 3, 1987

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM THE TRADE POLICY REVIEW GROUP

SUBJECT: TELECOMMUNICATIONS: POSSIBLE SELF-INITIATION OF 301s

Issue

The Economic Policy Council has requested that we determine whether certain countries' telecommunications trade and investment practices would be actionable under Section 301 of the Trade Act of 1974, in preparation for its review of possible self-initiation of 301 investigations. In preparing this issue for EPC review, the TPRG has ranked the countries under review in terms of the restrictiveness of their practices.

Background

o U.S. industry does not support initiating any section 301 complaints on telecommunications at this time. As indicated in a meeting with industry reps on August 24, this is true both of those who support and those who oppose telecom legislation.

-- The former believe current legislation contains a more positive, clear and productive approach.

-- The latter are concerned that initiation of 301s at this time will be seen as "caving in" to Congressional pressure and are concerned about possible limitations on access to imported equipment.

-- Current telecom legislation requires the Administration to develop objectives for telecom with industry input, enter into negotiations, and achieve results or retaliate, generally within three years.

o The TPRG reviewed 12 countries to determine their significant barriers, the extent to which practices are unreasonable within the meaning of section 301, the estimated effect of barriers, the history of consultations, and advantages and disadvantages of self-initiation. Individual country reviews are attached.

o The following common themes became apparent in the technical review at the staff level leading up to the TPRG discussion:

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-- The Administration's willingness to self-initiate would demonstrate high priority attention to telecommunications, partly in response to Congressional and private sector concerns.

-- On the other hand, self-initiation could be counter-productive, since many countries are taking or contemplating steps toward liberalization, and the more confrontational approach might reverse this trend. Moreover, taking action against any EC Member State in particular would enable that country to shift the locus of negotiation to the Commission, which has no competence over national PTTs.

-- For most countries studied, it could be argued that their practices are unreasonable within the meaning of section 301, based on lack of national treatment and/or of fair and equitable market opportunities. Therefore, they would be actionable under section 301 if they burdened or restricted U.S. commerce. However, since the U.S. has one of the very few open telecommunications markets, it may be inappropriate to label widespread, common foreign practices as unreasonable.

-- Most of the burdensome and potentially unreasonable practices are nevertheless not inconsistent with countries' GATT obligations. Were we to retaliate ultimately by restricting imports of goods, we would likely violate our own GATT obligations, leaving ourselves open to possible GATT sanctions.

-- For countries with which we have treaties of friendship, commerce and navigation (FCN) (e.g., which includes all countries reviewed, except China and Brazil), those accords probably do not provide an international legal basis for action, since communications enterprises are largely excluded from the key establishment article in such treaties. Were we to retaliate in such instances, we could also be accused of breaching the MFN obligations of the FCN.

-- It is not clear that we have the necessary leverage through taking or threatening 301 action on telecom trade to open foreign markets. Countries that have the most restrictive practices (e.g., Germany) may be net telecom importers from us; countries that have a telecom surplus (e.g., Japan) may have relatively more open policies. Thus, we would probably need to restrict import access on non-telecom items if retaliation were necessary.

-- We need to assess each case carefully in light of current bilateral and multilateral efforts. Self-initiating in telecommunications could "poison the well" for achieving positive results in other on-going issues (e.g., Airbus).

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Moreover, initiation of 301s could result in overt or covert retaliatory action against U.S. firms based overseas.

-- Achieving only national treatment may be a Pyrrhic victory in countries with telecommunications monopolies; in those cases, improvements in market access should be sought.

Interagency Consideration

The Trade Policy Review Group (TPRG) reviewed a number of options regarding self-initiation.

o There was considerable skepticism about self-initiating 301 action at this time, particularly in light of private sector opposition. At the same time, there was concern that our current low profile strategy on telecommunications will continue to yield only minimal results. Consequently, a more aggressive strategy short of self-initiating a 301 is needed, although no specific suggestions for such a strategy were put forward. It was also agreed that a decision not to take 301 action at this time should not preclude possible self-initiation at some future date, and that we should send a clear signal to our trading partners that future 301s are not precluded.

o The TPRG also considered self-initiation only against Germany. Agencies generally agreed that Germany's practices are among the most restrictive and its market among the most significant. However, it would be difficult to justify singling out Germany's practices, since they are no more egregious than certain other countries' barriers. It was also pointed out that there are certain powerful forces for liberalization in Germany that could be undermined by self-initiating a 301 at this time. Moreover, there are certain non-trade factors with regard to Germany that must be considered at present (i.e., Germany's role in U.S./Soviet arms negotiations).

Country Ranking

To facilitate EPC consideration of individual countries, the TPRG ranked them broadly according to the restrictiveness of their practices. At the same time, the TPRG believes the EPC should take certain other factors into account in any final "accounting" of countries, including the significance of the market, the relative importance of telecommunications on our bilateral trade agenda, and the chances for the success of a section 301 effort. Countries are listed below in broad categories of restrictiveness of barriers. China and India, although reviewed by the TPRG, are not included on the table, because they were considered entirely inappropriate for any 301 action.

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COUNTRY RANKINGCountryOther ConsiderationsMost Restrictive

Brazil	Would complicate efforts to conclude earlier self-initiated 301 (informatics). Slim chances for success.
Germany	Long history of unsatisfactory consultations. Should consider relative to importance of non-trade issues at this time (i.e., arms negotiations).
Korea	Consultations only began within past year; going fairly well. Other priority issues "on our plate."

Less Restrictive

Austria	Non-EC European country (therefore no "competence" problem). But, have held no consultations.
France	Has made some moves toward liberalization.
Italy	Not as large as other EC markets and not as influential in policy-setting. Actual practices more liberal than regulations.
Spain	New law being considered would be step in right direction, although not sufficient.

Least Restrictive

Netherlands	Although existing system is undesirable, considering legislation that would make significant improvements.
United Kingdom	U.K. telecom system is the most liberal in Europe.
Japan	From regulatory standpoint, relatively open, although real market access improvements have not occurred to the extent we would like. \$60 billion trade surplus with us should be considered.

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September 3, 1987

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: THE TRADE POLICY REVIEW GROUP

SUBJECT: SECTION 301 DEVELOPMENTS

Summary

This memorandum outlines likely section 301 developments between now and year's end. The Economic Policy Council may wish to take them into account in deciding whether to initiate investigations or recommend action under section 301 to the President regarding telecommunications, Korean insurance, and Japan Kansai practices.

EC Meat Issues

Third Country Meat Directive. On May 1, 1987, the EC began implementing its Third Country Meat Directive, which precludes the importation of meat products from any plant outside the EC that does not pass EC inspection. The directive establishes detailed requirements, such as:

- o the maintenance of separate rooms for various meat slaughter and processing operations, and
- o a prohibition on the use of wooden pallets, knife handles, structural beams or fencing.

Of the more than 400 U.S. plants inspected by the EC since 1984, only 7 slaughter and 3 cutting plants have been certified. Another 59 slaughter plants are approved only until December 31, 1987, and must be reinspected by EC officials.

In 1986, U.S. meat exports (beef, veal, pork, horse and variety meats) to the EC exceeded \$165 million in value, or about 15 percent of total U.S. meat exports that year. USDA currently accepts meat imports from over 250 European plants.

Last year we undertook a fact-finding investigation under section 305 of the Trade Act of 1974 on our own motion. The EC offered to cooperate but never responded to the questions we posed.

On July 22, Ambassador Yeutter initiated a section 301 investigation in response to a petition filed by the American Meat Institute,

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U.S. Meat Export Federation, National Pork Producers Council, American Farm Bureau Federation and National Cattlemen's Association. They charge that the directive denies national treatment (because its standards are not enforced in trade between EC member states, and do not apply within member states), and cannot be justified on the basis of scientific evidence. Because these issues arise under the GATT and Standards Code, we requested consultations under Article 23:1, which are scheduled this month.

However, we have no realistic hope of achieving an outcome under GATT dispute settlement procedures by January 1, when the temporary approvals of 59 U.S. plants expire. Unless they are certified, the result will be either a reduction in U.S. meat exports to the EC, or the incurrence of unnecessary expenditures by U.S. plants to conform to EC requirements.

EC Hormones. In January 1987, the U.S. asked for consultations under the Standards Code to complain of the EC's Animal Hormone Directive. This directive precludes the importation into the EC after January 1, 1988, of any meat produced from animals treated with hormones (which is widespread in the U.S.). We believe that hormones can be used safely under prescribed conditions, and that the EC should accept our residue testing program as a sufficient guarantee of the safety of meat from animals treated with hormones.

After the Standards Code Committee was unable to achieve a mutually satisfactory solution, in July 1987 the U.S. asked for the establishment of a technical experts group. The EC has blocked its establishment, interrupting the dispute settlement process. Unless the EC agrees soon to proceed, we may wish to consider self-initiating an investigation or acting under section 301. Even if the EC permits dispute settlement to proceed, however, it could not be completed prior to the implementation January 1 of the EC directive.

As a result of the Third Country Meat and Animal Hormone Directives, as of January 1, 1988, we expect U.S. exports of meat products to the EC to cease abruptly. The issue for the EPC will be whether and how to act unilaterally absent a satisfactory resolution in the interim. This issue must be addressed no later than early November, if public comment on proposed retaliatory measures were to be obtained and retaliation implemented by January 1.

Argentina Soybeans

The Government of Argentina has maintained higher export taxes on soybeans than on processed soybean products. This differential discourages the exportation of beans, puts downward pressure on the price of soybeans in Argentina, and thus provides a competitive advantage to the Argentine crushers of soybeans into soybean meal and oil.

In response to a petition filed by the National Soybean Processors Association in 1986, we initiated a section 301 investigation.

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Last May, the President suspended this investigation based upon the Argentine Government's commitment to eliminate or substantially reduce all export taxes by October 15.

On July 20 Argentina eliminated or significantly reduced the export taxes on all products except soybeans and sunflower seeds. It reduced the differential in taxes on soybeans and processed soybean products from 12 to 11 percent, which we do not consider a substantial reduction.

We are pressing the Argentine Government to fulfill its pledge by October 15. Argentina's Finance Minister will meet with Ambassador Yeutter at the end of September to discuss the problem. However, for Argentine domestic political and revenue reasons, we are skeptical how far the Government will move.

Agencies agree that this export tax differential distorts trade; despite repeated deliberations within the Section 301 Committee, they still disagree whether it is unjustifiable, unreasonable or discriminatory and a burden or restriction on U.S. commerce (the criteria of section 301). However, breach of Argentina's commitment to eliminate or substantially reduce all export taxes by October 15 would be independently actionable under section 301 as unjustifiable, if it also burdened or restricted U.S. commerce.

Absent a satisfactory settlement by October 15, the issue for the EPC will be whether and how to respond to Argentina's breach of its commitment and maintenance of an export tax differential that distorts trade. This issue would arise as of October 15, but there would be no need to act immediately to preserve the status quo (as in the EC meat matters).

Argentina Air Couriers

In 1984 the Air Courier Conference of America complained of the Argentine Government's restrictions on the delivery of time-sensitive commercial documents, which essentially prohibited U.S. couriers from the international carriage of such items. In November 1984 the President determined this practice to be unreasonable and a restriction on U.S. commerce. He directed the Trade Representative to consult further with Argentina, but to submit proposals for action under section 301 within 30 days if the issue were not resolved through consultations.

With the help of this leverage, we persuaded Argentina to eliminate its restrictions. However, it replaced the restrictions with a discriminatory tax on international courier operations, which our industry maintains bore no reasonable relationship to the cost of any services provided. Recently the Argentine Government allegedly has harassed the local franchise of one U.S. company, DHL, on the basis of purported ties to British interests. In addition, the Government is replacing the clearly discriminatory tax system with a nondiscriminatory tax system that may operate nonetheless to the disadvantage of international couriers and to the advantage

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of the Argentine monopoly postal authority, ENCOTEL.

The Section 301 Committee will review the new draft regulations as soon as they are available and meet with U.S. industry representatives and GOA officials. If the Committee concludes that the Argentine Government simply would be replacing one unfair and burdensome practice with another, it will recommend any appropriate action to the Trade Policy Review Group.

Brazil Informatics

President Reagan suspended the procedural and market reserve portions of this case in December 1986, and the intellectual property portion on July 1. The latter suspension was based on passage by Brazil's Chamber of Deputies of legislation that would provide adequate copyright protection to computer software.

However, Brazil's Senate does not consider this legislation urgent and may delay its consideration until it completes drafting the Constitution. More ominously, the Brazilian private sector opposes the bill's market reserve provisions for software, which prohibit software imports if a Brazilian company produces a "functional equivalent." Brazilian software user and producer associations have asked the Senate leadership to replace this provision with a tax on imported programs. If the Senate amends the bill, it will be sent back to the Chamber of Deputies, where nationalistic deputies are likely to try to derail the entire bill if they believe that the market reserve policy is threatened.

To further complicate matters, Brazil's Secretariat for Informatics may shortly approve a pending license application for a Brazilian clone of the Apple MacIntosh 512 personal computer. Depending upon these developments, the EPC may have to consider whether to reopen the intellectual property portion of this case. (The investment portion remains active.)

Other Current Section 301 Cases

The following are major developments and deadlines in other active Section 301 cases:

- o Canada Fish (concerning Canadian prohibitions on the export from Canada of unprocessed salmon and herring): We expect the GATT panel report in October. The deadline for the Trade Representative's recommendations to the President is 30 days following the conclusion of dispute settlement.

- o India Almonds (concerning Indian licensing requirements and steep tariffs on imports of almonds): At the Indian Government's request, a second round of GATT consultations is scheduled for the week of September 28; and we have asked for the establishment of a panel in the Licensing Code Committee. The deadline for the Trade Representative's recommendations to the President is 30 days following the conclusion of dispute settlement.

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o Brazil Pharmaceuticals (concerning Brazil's lack of product or process patent protection for pharmaceutical products): After three rounds of consultations, the Brazilian Government indicated it would not grant either product or process patent protection for pharmaceuticals. Public hearings are scheduled for September 14. The deadline for the Trade Representative's recommendations to the President is July 23, 1988.

Possible Section 301 Industry Petitions in the Wings

In addition to pending cases, we are aware of the following petitions that could be filed by U.S. industry:

o Canada wine (concerning provincial barriers to the sale of U.S. wine in Canada): The Wine Institute submitted a draft petition this summer, and is likely to file if FTA negotiations do not resolve this trade barrier.

o Canada printing (concerning various Canadian barriers to the importation of certain U.S. printed publications): Printing Industries of America, Inc. submitted a draft petition late last spring, apparently intended to serve as leverage in the FTA negotiations.

o UK/FRG/France/Spain Airbus (concerning subsidies and inducements to the purchase of Airbus aircraft): Boeing and McDonnell Douglas continue to consider the possibility of petitions under section 301 and/or the antidumping and countervailing duty laws.

o EC Soybeans (concerning the EC's domestic subsidies for soybeans): The American Soybean Association has submitted a second draft petition which the Section 301 Committee is reviewing. ASA says it plans to file September 16, and is determined to proceed regardless of agency comments. This would be a blockbuster case. In 1986 U.S. oilseed and oilseed product exports to the EC totaled \$2.3 billion, compared to \$4.2 billion five years ago. If filed and initiated, it presumably would be handled as a GATT case; therefore, the deadline for the Trade Representative's recommendations to the President would be 30 days following the conclusion of dispute settlement.

o Argentina/Chile Pharmaceuticals (concerning those countries' lack of product patent protection for pharmaceuticals): The Pharmaceutical Manufacturers Association (petitioner in the Brazil case) advises us that they plan to file petitions on Argentina and Chile as well in November.

Another Possible Self-Initiation Candidate

Finally, at some point agencies may be called upon to review

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again Japanese soda ash practices. Several times we have considered whether to self-initiate an investigation based upon possible cartel activities among Japanese firms tolerated by the Government, and U.S. soda ash producers' failure to sell as much soda ash in Japan as their comparative advantage would warrant. Senators Wallop and Symms have urged us repeatedly to consider action under section 301.

To date, however, the Justice Department and some other agencies have opposed this step based upon insufficient evidence of the continuation or resumption of an earlier cartel. The Section 301 Committee is monitoring this situation, and will recommend action to the Trade Policy Review Group if evidence of unfair and burdensome practices by the Japanese Government develops.

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DEPUTY UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON, D.C. 20506
202-395-5114

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September 10, 1987

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM : THE TRADE POLICY REVIEW GROUP

SUBJECT: SECTION 301 ACTION AGAINST KOREAN INSURANCE PRACTICES

ISSUE

Should the President determine under section 301 that Korean practices involving access to its life insurance market are unfair and direct the development of appropriate and feasible counteraction.

RECOMMENDATION

There is consensus in the TPRG that the President issue a section 301 unfairness determination and that, absent a satisfactory negotiated solution, announce retaliation (to be developed by the TPRG) on October 16, 1987.

THE 1986 SECTION 301 AGREEMENT

o Last year we concluded a self-initiated section 301 action against Korean insurance practices intended to provide full market access to that market for U.S. companies. The 1986 agreement (attached) specified that qualified U.S. insurance firms would be promptly licensed. No reference was made to the form of establishment -- branch office, subsidiary or joint venture -- under which U.S. insurance firms would be required to operate in either the life or non-life insurance markets.

o The United States government consistently maintained its position that restrictions on the form of establishment for entry into the Korean insurance market were unacceptable. During April trade consultations and the July Economic Consultations, the Koreans were put on notice that failure to allow joint ventures and subsidiaries in the life market would be viewed by the United States as a derogation of the agreement.

REMAINING MARKET ACCESS BARRIERS

o Implementation of the agreement to date has produced mixed results. U.S. firms have been admitted to the compulsory fire

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pool, two limited life licenses have been approved and numerous procedural/regulatory issues have been resolved. However, we have not achieved the objective of full market access to the life insurance market as a result of Korean limitations on participation in that segment of the market to branch offices.

LEGAL BASIS FOR ACTION

o Ambiguity in the language of the 1986 agreement makes it difficult to assert unequivocally that Korea has violated the agreement. Nonetheless, Korea's pattern of interpreting and implementing the agreement in an unduly narrow manner has prevented U.S. firms from gaining full entry to the life market.

o The August 18, 1987 Korean decision to reject a bona fide joint venture application, as well as its stated intent to reject future joint venture applications and applications of U.S. subsidiaries, clearly signal the Korean policy of continued protection of its life insurance market. Other practices -- such as delays in the issuance of licenses, limitations on the number of products that U.S. insurance firms may market and requirements concerning renewal of licenses every two years-- also underscore the Korean intention to attempt to implement the 1986 agreement in a minimalist fashion.

o It is the consensus of the TPSC Korea Subcommittee responsible for monitoring implementation of the 1986 section 301 agreement that further technical level consultations under the consultative mechanism of the agreement will not accomplish the goal of increased access for U.S. firms. Elimination of restrictions on form of establishment would require a ministerial level decision in Seoul. Such a decision is unlikely in the absence of an unfairness determination and a direction to recommend counter-measures.

o Because these practices deny national treatment and fair and equitable market opportunities, they may be considered unreasonable under section 301. Because they also burden and restrict U.S. commerce (by limiting the sale of insurance by U.S. firms in Korea), they are actionable under section 301.

o In addition, we believe these restrictions violate Article VII of the 1956 U.S.-Korea Treaty of Friendship, Commerce and Navigation. Article VII accords national treatment "with respect to engaging in all types of commercial,...financial and other activities for gain (business activities)..., whether directly or by agent or through the medium of any form of lawful individual entity." In our opinion, the broad scope of this provision covers insurance services. Consequently, Korean government acts, policies and practices are also unjustifiable under section 301.

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PRIVATE SECTOR VIEWS

o The Korean insurance market is the 10th largest in the world with 1986 total life premiums of \$6.3 billion. The life market grew at an average annual rate of 30 percent between 1982-1986. Industry analysis predicts average annual growth of 20 percent in the Korean life market over the next five years. Again according to industry analysis, roughly five years of operation by new entrants to the market are required before profits are earned. The International Insurance Council estimated in 1986 that U.S. firms would be able to capture immediately a 5 percent market share if allowed to operate without restriction on form of establishment. We believe this is a conservative estimate given the industry's interest in pursuing entry into the Korean market following the 301 agreement, i.e., letters of intent or applications from six U.S. firms.

o U.S. insurance firms have actively supported our efforts to aggressively enforce the 1986 section 301 agreement. Preliminary soundings of the industry indicate that it will support retaliation.

POSSIBLE RETALIATION

o Based on industry analysis, we estimate that the 1986-90 Korean life market will approximate \$55 billion in total premiums. Using an average annual premium level of \$11.3 billion, we estimate that U.S. firms are losing in the range of \$550 million to \$1.1 billion in life premiums annually.

o Preliminary interagency discussions have focused on developing a retaliation package based on imposing prohibitive tariffs on Korean exports in the \$0.5 to \$1.0 billion range (1986 Korean exports to the U.S. were valued at \$13.4 billion).

o It is generally agreed that textiles covered by the bilateral agreement and steel items under restraint should be excluded from any retaliation package. Products appropriate for consideration would include, inter alia, automobiles, various consumer electronics, computers, certain footwear, automobile tires, and processed agricultural products.

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September 3, 1987

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: THE TRADE POLICY REVIEW GROUP

SUBJECT: JAPAN KANSAI AIRPORT CONSTRUCTION PRACTICES

Issue

The Economic Policy Council is to decide whether the Trade Representative will self-initiate a section 301 unfair trade investigation of Japanese Government practices in connection with the construction of the Kansai Airport.

Kansai Airport

The Airport Project: The Kansai International Airport Corporation (KIAC) is building an over \$7 billion airport near Osaka. KIAC is a "special" company established under the Kansai International Airport Corporation Law and controlled by the Ministry of Transportation. For example, the Ministry:

- o holds two thirds of KIAC shares;
- o authorizes any issuance of additional shares;
- o approves KIAC's yearly business plan and any subsequent changes to it, the appointment and dismissal of KIAC directors and auditors, and any changes in its articles of incorporation; and
- o in consultation with the Ministry of Finance, can veto KIAC's access to capital markets.

As a result, we consider KIAC an instrumentality of the Government of Japan.

Airport construction is scheduled to proceed in four phases: (1) building sea-walls, landfill and a bridge linking the airport island to the mainland, which has begun; (2) constructing the airport (runways and terminal building), expected to begin in 1990; (3) equipping the airport, scheduled to conclude by 1992; and (4) expanding the airport to include two more runways.

While sizable by itself, the Kansai Airport project is the first of several major such Japanese undertakings including the Trans-Tokyo Highway Bay Bridge and Narita Airport expansion projects.

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Particularly in view of the collapse of the Middle East construction boom and LDC debt constraints, the Japanese market and Japanese-financed projects in third countries are viewed as good prospects for the U.S. construction, civil engineering and architectural design industries outside the U.S. These industries therefore attach great importance to the Japanese market, particularly since Japanese participation in the U.S. construction market is growing (from roughly \$1.8 billion in 1985 to \$2 billion in 1986 and an estimated \$3.4 billion in 1987).

Practices Actionable Under U.S. Domestic Law. KIAC uses non-transparent, discriminatory procurement procedures; for example:

- o It does not release specifications and information necessary for foreign firms to prepare responsive bids in a timely manner.
- o It does not notify unsuccessful applicants of its decision to award a contract to another bidder, or provide any right of appeal.
- o It has refused even to consider foreign firms for phase 1 of the project (which accounts for two thirds of its expected costs).
- o It decides which firms will be allowed to submit bids on major construction contracts based upon subjective criteria, including experience and qualifications in Japan. This presents a chicken-and-egg problem, since no U.S. company has been awarded a major Japanese construction project since 1965.
- o Dango, a practice whereby Japanese construction companies collude on bids and pricing to parcel out construction jobs to each other (and exclude outsiders), likely influences KIAC's procurement.

Since we consider KIAC an instrumentality of the Japanese Government, its practices are actionable under section 301 if they violate or deny benefits under a trade agreement, or are otherwise unjustifiable, unreasonable or discriminatory and a burden or restriction on U.S. commerce. These practices probably do not violate the GATT, Government Procurement Code or U.S.-Japan Treaty of Friendship, Commerce and Navigation (FCN). However, they may be said to deny national treatment and fair and equitable market opportunities. Consequently, they may be considered "unreasonable" and "discriminatory" under section 301. They also burden or restrict U.S. commerce, since U.S. design, engineering, construction and consulting experience--particularly in airport design and construction--is so well established that we could fairly assume that we would be competitive in Japan if given fair access to the

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market. Therefore, as a matter of U.S. domestic law, they are actionable under section 301.

Retaliation and U.S. International Obligations. If we were unable to settle this case and compelled to retaliate, we are uncertain how large the retaliation package would be. Commerce's current best estimate, based on a contracted study, is that U.S. firms could reasonably expect to win up to \$270 million in equipment and \$6 million in services contracts, if given fair access to Kansai procurement. However, this is a rough guesstimate that would require refinement as more information becomes available on Phases 2 and 3 of the project.

We would have difficulty retaliating against Japanese construction services in our market. Section 301 authorizes restriction of prospective, federal "service sector access authorizations" and/or the imposition of fees on services (either against the country concerned or on a nondiscriminatory basis).

- o A "service sector access authorization" is defined as a license, permit or regulatory approval that facilitates access by the foreign service industry to the U.S. market. However, almost all such permits required by the construction industry are state or local rather than federal.
- o Moreover, imposition of fees or restrictions on "services of Japan" would require us to determine the origin of the services provided. Such retaliation could violate our FCN obligations.
- o Neither federal service or construction contracts are covered by the Government Procurement Code. Therefore, any such retaliation against services would not be inconsistent with the Code.

Of course, section 301 also authorizes increased duties or other import restrictions on imports of products. (Regarding procurement, our Buy American laws already discriminate in the procurement of goods used in carrying out a federal construction project.) U.S. retaliation against products of Japan would violate our GATT and FCN obligations. Moreover, any retaliation against any procurement of products covered by the Government Procurement Code would violate it as well.

The Trade Bill. Both H.R. 3 (sec. 908) and S. 1420 (sec. 310) have precisely identical provisions requiring the Trade Representative, within 90 days of enactment, to self-initiate an investigation of Japanese Government barriers to the offering or performance by U.S. persons of architectural, engineering, construction and consulting services. (In fact, the original Murkowski amendment approved by voice vote on the first day of

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the Senate's debate on S. 1420 was later amended to parrot the House provision precisely.) Senator Murkowski moved the Senate amendment on the floor; on Rep. Ritter's initiative, the House Energy and Commerce Committee included the amendment as a noncontroversial matter in its title of H.R. 3.

Moreover, as amended by Senator Murkowski, the Airport and Airway Capacity Expansion Act of 1987 (S. 1184) would prohibit the use of FAA funds for any product or service of a foreign country until USTR determines that such country has a reciprocal policy permitting fair and equitable market opportunities for U.S. firms. This bill has been reported out of the Senate Commerce Committee and is pending floor action.

Private Sector Views. The industries involved include: (1) design firms specializing in architecture and engineering, (2) mainline construction firms and (3) equipment manufacturers. Their interests diverge. Equipment manufacturers are satisfied so long as they can sell their products; they currently believe that pressure on Japan improves their prospects. Two trade associations (the National Constructors Association and the Associated General Contractors) have publicly called for action by the United States to open up the Japanese market. The International Engineering and Construction Industries Council will reportedly soon issue a statement supporting the identical provision in H.R. 3 and S. 1420. U.S. industry representatives in Japan agree that a section 301 investigation would not hurt their efforts to penetrate the Japanese market. However, we believe that many U.S. construction companies and concerned Members of Congress may consider a section 301 case primarily as a vehicle for closing the U.S. market to Japanese competitors. If so, they are likely to be disappointed, since retaliation against Japanese construction services would be difficult for the reasons outlined above.

U.S. and International Air Carriers. Both U.S. and international air carriers fear that design problems that lead to inefficient operations at Narita Airport are being repeated at Kansai airport. Many airlines are prepared to suggest design alternatives that could improve operations at Kansai but have been excluded from the design process. U.S. officials have expressed serious concern to Japanese officials to encourage a sympathetic hearing of other points of view regarding Kansai's design, but have not yet met with success.

Recent USG Efforts to Open the Kansai Market. A chronology of our longstanding efforts to open the Japanese construction market and in particular develop opportunities at Kansai is attached at Tab 1. The highlights are the following:

- o May 1986: Ambassador Yeutter writes the Minister of Transportation to indicate concern about Japan's

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unwillingness to allow U.S. firms to compete for Kansai contracts.

- o June 1986: Murkowski and nine other Republican Senators request information on Kansai under section 305 of the Trade Act.
- o July 1986: Prime Minister Nakasone assures Secretary Baldrige that U.S. firms will be permitted to bid on the latter phases of the project on a "fair and equal" basis.
- o July 1986: TPRG decides to try to resolve Kansai through continued bilateral efforts under Commerce leadership.
- o August 1986: USTR provides information to Senator Murkowski and others under section 305.
- o August 1986: President Reagan writes Nakasone to thank him for his offer to sponsor a seminar on the Kansai project.
- o September 1986: Prime Minister Nakasone responds that he will keep "close personal watch over this issue," but warns it should not be given more importance "than it deserves."
- o October 1986: Commerce organizes a Presidential Trade Delegation with ten industry executives to meet with GOJ and KIAC officials to discuss U.S. participation. These executives and some other U.S. business representatives attend KIAC seminar in Osaka.
- o November 1986: Secretary Baldrige writes Ambassador Matsunaga to reiterate the importance of U.S. participation in Kansai project.
- o January 1987: Assistant Secretary of Commerce Goldfield negotiates U.S. access with GOJ in Tokyo and KIAC in Osaka.
- o May 1987: Commerce Deputy Under Secretary Ferren opens U.S. pavilion at International Airport Construction and Engineering Exhibition in Osaka. Over 60 U.S. firms exhibit their equipment and services.
- o August 1987: Japanese make "final" offer to Under Secretary of Commerce Smart that includes:
 - 30-day notification of equipment procurement over \$150,000 SDRs;

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- 30-day notification of construction contracts over \$5 million;
- 40-day notice to prepare bids on equipment contracts;
- 60-day notice to prepare bids on construction tenders;
- advertising for consulting services contracts over \$500,000;
- notification of non-selection by KIAC and reasons therefor;
- acceptance of overseas credit ratings, qualifications, experience and test data;
- specifications for equipment and materials based on performance rather than generic criteria;
- provision of appeals to: (1) the International Affairs Office of KIAC, and (2) the Kansai International Airport Division in the Ministry of Transportation; and
- consideration of international arbitration of disputes on a contractual basis.

This "offer" applies only to the Kansai project, and not to other Japanese construction projects. Although this offer represents some movement by the Japanese Government (which it may consider quite significant), it falls short of establishing the transparent, nondiscriminatory procurement system we desire.

Pros of Self-Initiation:

- o Increases pressure on Japan and KIAC, without which we and our construction and design industries believe we will gain nothing more, and may lose even our modest gains to date.
- o Shows our commitment to open this traditionally closed Japanese market despite GOJ intransigence.
- o Establishes a time limit on negotiations, since the Trade Representative would be required to recommend action to the President within one year of initiation.
- o Responds to a particularly egregious unfair trade practice, for which there is no other logical next step except further negotiations.

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- o Could build on our track record of concluding procurement agreements with Japan (NTT, supercomputers).

Cons of Self-Initiation:

- o May be too late to reap any political credit for self-initiating, given identical provisions in both bills and the broader coverage of those provisions.
- o Would be perceived as rejecting Prime Minister Nakasone's pledge on this matter.
- o The Japanese Government may not have sufficient leverage over the influential construction industry to enforce a new, nondiscriminatory procurement system.
- o Absent a satisfactory settlement, may result in retaliation that probably would not reduce Japanese participation in the U.S. construction market, which may be U.S. construction industry's real aim.
- o Could jeopardize potential equipment sales on Kansai project.
- o Picks a big fight with Japan at a time when we're also juggling the trade bill, Canada FTA negotiations, other section 301 matters, etc.
- o If compelled to retaliate, such retaliation could provoke a successful Japanese challenge in the GATT or under the FCN (which calls for submission of disputes to the International Court of Justice unless some other agreement is reached).

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KANSAI INTERNATIONAL AIRPORT PROJECT
CHRONOLOGY

- 5/28/86 USTR Yeutter writes to Minister of Transportation Mitsuzuka saying: (1) Japan is ignoring its international obligations by restricting participation to domestic designated bidders; (2) the GOJ holds 2/3 of KIAC and is obliged at a minimum to ensure that KIAC adopts a system of open competitive bidding; (3) exclusion of foreign bidders is contrary to Japan's commitment to a more open market under the Action Program and the Maekawa Report; (4) USG reserves right to pursue the restrictive bidding issue bilaterally or in multilateral fora.
- 6/5/86 Baldrige letter to Nakasone requests open bidding procedures and cites projects Japanese firms have undertaken here.
- 6/19/86 Senate Republican Conference Task Force on International Trade Policy (chaired by Murkowski) requests USTR section 305 inquiry.
- 7/15/86 Nakasone becomes involved: instructs his cabinet that Kansai project should not become a source of embarrassment.
- 7/23/86 Matsunaga letter to Yeutter argues Japan not shirking its international responsibilities, there is no discrimination against foreign companies -- Procurement Code not applicable, KIAC is private, foreign participation in Phase I impossible; describes designated bidding system.
- 7/28/86 Nakasone assures Baldrige that U.S. firms will be permitted to bid on the later (post-landfill) stages of the project on a "fair and equal" basis. Baldrige warns Nakasone that "Kansai is on the way to becoming an emotional national issue". Nakasone answers that there are no international rules for tendering construction projects, and that the Kansai Airport Project will be carried out according to the established rules and practices of Japan. These do not exclude foreign firms, he continues, but do present a "challenge" which interested parties will have to overcome. Nakasone conveys his assurances to President Reagan that foreign firms will be able to compete on a fair and equal footing in the latter stages of Kansai project.
- Baldrige does not concede U.S. access to sales of equipment for Phase I, or on any of Phases II and III (when actual airport and handling facilities will be built and tower control equipment will be purchased).
- 7/28/86 Hashimoto Meeting - Transportation Minister Hashimoto promises Baldrige that he would not permit Japanese firms to form a group which could exclude foreign participation.
- 7/30/86 On the basis of Nakasone and Hashimoto promises, TPRG agrees to

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endorse Commerce-proposed seminar for potential U.S. suppliers, and to seek GOJ commitment that no contracts for the project would be let until procedures consistent with Nakasone's commitment were developed and explained to U.S. firms; Commerce mission under Smart to pursue equal access in procurement procedures.

- 8/7/86 Baldrige letter to Hashimoto transmits this expectation, proposing KIAC Seminar, pressing for open access, and seeking GOJ commitment that no contracts for the project would be let until procedures consistent with Nakasone's commitment were developed and explained to U.S. firms. States "only full and immediate implementation of this policy will forestall formal trade action by my Government." Requests written understanding spelling out principles of a non-discriminatory system to be applied to Kansai and other major public works contracting.
- 8/15/86 Section 305 Response - Yeutter sends nonconfidential summary of available information on Kansai issue to requesting Senators. Response concludes that GOJ has effective control over the KIAC and that the KIAC has so far followed "nontransparent, discriminatory procedures."
- 8/15/86 Pres. Reagan writes to Nakasone thanking him for his offer to sponsor a seminar for U.S. firms interested in participating in the Kansai project. As a symbol of the "great value which I personally place on the effort," President informs Nakasone that he is sending a Presidential Trade Delegation to participate in the seminar and to assess "extent of real business opportunities for us."
- 8/18-22/86 Smart visit to Tokyo; during 4-day visit, Smart unable to obtain "set of principles" or other such written commitment to specific open principles. Letter from MOT Min. Hashimoto states that details of procedures for contracts other than in initial phase of project are not decided, and assures that U.S. firms will receive timely and equal access to information on contracting methods, procurement plans, bid procedures and award criteria, and be treated no less favorably than Japanese firms when contracting methods are developed.
- 9/3/86 Nakasone Letter to President- Nakasone indicates that he will keep "close personal watch over this issue," but cautions that the issue should not be given more importance "than it deserves."
- 10/6&7/86 Presidential Trade Delegation, 77 high-level representatives from over 47 U.S. firms in U.S. construction services industry, meets in Tokyo with GOJ and Japanese industry to discuss KIAC bidding and procurement procedures, and attends seminar given by KIAC in Osaka. Seminar provides some information and contacts, but no clear understanding of content or timing of KIAC procurement. KIAC points to opportunities in Phase I consulting work and equipment/machinery supply, but GOJ and KIAC hold firm on closing

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bidding process for Phase I, seem intent upon keeping foreign involvement in other phases to a minimum.

Nagoya Visit: U.S. del meets with Aichi Prefecture Gov. Reiji Suzuki to discuss plans for Chubu International Airport project.

- 10/10/86 Goldfield letter to Vice Min. of Construction Toyokura asks MOC: (1) to provide all necessary information for U.S. firms to obtain registration and licenses; (2) to give favorable consideration to U.S. firms' applications in light of American worldwide experience; (3) to provide specific information on contract awards, including characteristics and relative advantages of winning tenders, and contract prices; (4) to provide U.S. Embassy with a list of future major projects. Goldfield asks for assurances that U.S. firms will be able to obtain necessary information to participate from the start on major Japanese projects, such as proposed Trans-Tokyo Bay Highway; and asks that MOC establish an office where U.S. firms can get information and documents necessary to qualify.
- 10/10/86 Similar Goldfield letter to MOT Parliamentary Vice Min. Kakizawa asks MOT to provide all information needed to comply with procurement requirements. In addition to requesting the major elements contained in the Toyokura letter, Goldfield asks that MOT provide immediate and full access to American firms, and asks that MOT ensure quick responses to questions or complaints from U.S. firms.
- 10/31/86 Goldfield letter to Dirgen Watanabe of MOFA Economic Bureau requests list of associated works for the Kansai Airport project and local government entities supervising procurement; notes USG expectation that local government procurement procedures will be guided by principles of the Government Procurement Code, as stated in Japan's Action Program (July 1985).
- 10/31/86 Presidential Trade Delegation report concludes, "No discernible progress was realized on the broader objective of appraising specific steps taken by the Nakasone government to provide a 'fully open, transparent, and nondiscriminatory' bidding system." Many participants felt seminar just defended the designated bidding system, and formal explanation of open and competitive bidding procedures never happened.
- 11/2/86 At TPRG meeting, Goldfield states he will provide the TPRG a detailed list of Japanese bidding opportunities for U.S. firms, and will review Japanese bidding procedures and get the Japanese to change them to allow more open and timely access for U.S. suppliers. TPRG implies need for a commitment from Japanese on U.S. participation in Phase I subcontracting and equipment supply. Smith directs 301 Committee to evaluate actionability and explore retaliatory options.
- 11/12/86 Kakizawa reply to Goldfield insists that all information required

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to comply with procurement requirements was provided to the USG at the KIAC seminar; directs additional requests for information on specific MOT projects to the policy division of the Bureau of International Transport and Tourism. MOT agrees to provide information about specific projects named by USG, on a case-by-case basis. MOT provides its Five-Year Plan for Airport Improvements and the Five-Year Plan for Ports and Harbors Improvement. MOT recommends that private U.S. firms collect information on major projects, and make efforts to win confidence of commissioning entities for each project (an allusion to the Trans-Tokyo Bay Highway project) on which they wish to bid.

- 11/17/86 Toyokura reply to Goldfield pledges to treat U.S. firms' applications in the same manner as Japanese firms', while permitting U.S. companies to list their construction work outside Japan in their applications. MOC Economic Affairs Bureau designated as liaison office for U.S. firms to contact for information and consultation on specific problems. Toyokura declines to provide comprehensive list of all future major projects, but agrees to provide information on specific projects on USG request; advises American firms to gather project-related information and "make a corporate effort to convince the commissioning organization of their reliability.". Toyokura notes that commissioning organization itself performs project surveying, planning, and coordination, and thus has authority to decide which firms participate in bidding.
- 11/24/86 Baldrige letter to Amb. Matsunaga - states that he is pleased that a foreign company was included in consultants asked to draw up plans for Kansai terminal building, but expresses concern that the foreign company will not be on an equal footing with its Japanese competitors. Reiterates U.S. interest in participating in the island, bridge and associated works portion.
- 11/28/86 Watanabe reply to Goldfield stresses that MOFA and other national government agencies must respect local government autonomy, and therefore cannot supply a comprehensive list of associated works for the Kansai Airport project. However, Watanabe agrees to make available, through Embassy Tokyo, translated documents on general guidelines on transportation and infrastructure around the Kansai facility. Watanabe states that procurement of construction and other services is not covered by the GATT Government Procurement Code or the Action Program.
- 12/3/86 KIAC designates 31 marine and civil engineering firms for competitive bidding on the seawall; requests proposals for seawall construction to be submitted by 12/23/86. The 31 firms then organize themselves into 20 consortia.
- 12/7/86- Goldfield and interagency delegation meets with GOJ + KIAC for
12/11/86 three days. Goldfield asks Takeuchi for specifics of procedures for phases II and III, timetable for future contracts, and indication that U.S. companies will be invited to bid on forth-

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coming contracts for bridge substructure, island reclamation, design and engineering contracts, and rock crushing equipment; gives Takeuchi the Baldrige-Matsunaga letter.

Takeuchi agrees to consider worldwide experience of U.S. firms in assessing bidder responsibility, states new system for announcing contract awards effective Jan. 1, 1987: however, Takeuchi repeats that Phase I is off limits. In meetings, MOT shows similar lack of movement, while giving assurances that MOT will give administrative guidance to KIAC to ensure that principles of transparency and fairness are followed. MOC assures Goldfield that MOC will give guidance to ensure U.S. companies are given equal and fair treatment in projects under MOC jurisdiction. All ministries state Phase I is off limits (MOFA refers to deal between GOJ and construction interests to this effect).

- 12/7/86- Murkowski tours airport site, meets with Takeuchi; no
12/8/86 positive response.
- 12/23/86 20 consortia present proposals for seawall construction to KIAC on 12/23/86. The same day, KIAC announces that construction of airport seawall, divided into 6 sectors, has been awarded to 6 construction consortia including 20 companies; total contract value for the 11 km. seawall is ¥91,320 million (\$571 million). Construction will begin in January after MOC construction approval is granted.
- 1/9/86 International Engineering and Construction Industries Council (IECIC) approves position paper favoring consideration of self-initiated 301 case.
- 1/20- Smith and Smart visit Tokyo for talks on subjects including Kansai.
24/87
- 3/11/87 Sen. Murkowski testifies at House Energy and Commerce Committee hearing on Kansai.
- 3/16/87 Associated General Contractors adopt position paper endorsing self-initiation of a section 301 case.
- 3/18/87 Sen. Murkowski and 16 co-sponsors introduce S. 742, barring foreign firms from federally-funded airport construction unless a firm is from country that does not discriminate against U.S. firms in similar construction procurement.
- 3/19/87 Florio subcommittee of House Energy and Commerce Committee reports Murkowski language requiring initiation of section 301 investigation on construction and engineering sector trade barriers in Japan (not just Kansai); language reported out 3/25 by full committee, becomes section 908 of H.R. 3.
- 4/24/87 Smart meets with Takeuchi and hands him a letter, dated April 21,

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urging that KIAC adopt a list of specific improvements in procurement procedures (developed by Commerce staff spring 1987 through Kansai talks). Takeuchi discusses KIAC statement dated April 24, "Participation of Foreign Companies in the Kansai International Airport Project" (also published in the Kampo (official gazette)), which announces:

(1) Thorough non-discriminatory treatment will be given in designated bidding.

(2) Planned procurement for each fiscal year will be published in the Kampo (together with an English summary), stating quantities, type and delivery schedule, right after the yearly plan for work projects is determined. For contracts over a certain size, the subject matter, bid dates and names of designated bidders will be made available at the KIAC reception desk, and the subject matter, awardee(s) and contract amounts will be made available at the KIAC reception desk. KIAC will establish an international affairs office.

(3) KIAC will consult with foreign airport authorities in drawing up its air terminal design, and will seek cooperation from prominent foreign consultants in the area of internal airport systems to be adopted by KIAC in future.

(4) There will be ample opportunities for foreign companies in equipment procurement if they are competitive on price, quality and afterservice. Actual orders have already been placed with foreign companies.

(5) Actual collaboration between foreign and Japanese companies by joint venture or technical agreements is now in progress. This is one of the best approaches for enhancing foreign companies' participation. KIAC will introduce foreign companies to Japanese companies on request.

5/12- ACE Airport Construction Exhibition held in Osaka. 60 U.S.
5/15/87 companies attend, with facilitation by Commerce Department.

5/20/87 National Constructors Association approves position endorsing
self-initiation of section 301 case on Kansai.

6/15/87 Takeuchi writes back to Smart rejecting essentially all of USG
requests.

6/17/87 Kakizawa letter to Smith endorses Takeuchi letter.

6/19/87 Smart writes to Takeuchi stating that Takeuchi's letter is
unacceptable.

6/25/87 Senate approves Murkowski floor amendment to Senate trade bill by
voice vote (actively supported by NCA).

7/8/87 Takeuchi letter to Smart regrets lack of agreement, looks forward
to seeing Smart in August.

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- 7/15/87 Smart writes to Kakizawa of MOT, Watanabe of MOFA and Inoue of MOC urging the GOJ to reconsider his suggestions.
- 8/12/87- Smart and Farren visit Tokyo and Osaka, consult with MOT,
8/21/87 KIAC, MOC and MOFA. KIAC and GOJ make "final offer" to Undersec. Smart, including:
- 30-day notification of equipment procurement over \$150,000 SDRs;
 - 30-day notification of construction contracts over \$5 million;
 - 40-day notice to prepare bids on equipment contracts;
 - 60-day notice to prepare bids on construction tenders;
 - advertising for consulting services contracts over \$500,000;
 - notification of non-selection by KIAC and reasons therefor;
 - acceptance of overseas credit ratings, qualifications, experience and test data;
 - specifications for equipment and materials based on performance rather than generic criteria;
 - provision of appeals to: (1) the International Affairs Office of KIAC, and (2) the Kansai International Airport Division in the Ministry of Transportation; and
 - consideration of international arbitration of disputes on a contractual basis.
- "Offer" applies only to the Kansai project, and not to other Japanese construction projects. Although offer represents some movement by the Japanese Government, it falls short of establishing the transparent, nondiscriminatory procurement system we desire.
- 8/17/87 Farren sends Watanabe of MOFA a letter asking for improvement and clarification of some matters informally promised to us.
- 8/20/87 USG receives two draft procurement procedures, one each from MOT and KIAC.

Sept. 1, 1987

TO:

		ACTION	INFO	DATE	INITIAL
1	DCI				
2	DDCI				
3	EXDIR				
4	D/ICS				
5	DDI				
6	DDA				
7	DDO				
8	DDS&T				
9	Chm/NIC				
10	GC				
11	IG				
12	Compt				
13	D/OCA				
14	D/PAO				
15	D/PERS				
16	D/Ex Staff		X		
17	NIO/ECON	X			
18					
19					
20					
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22					

SUSPENSE

Date

Remarks


Executive Secretary

4 Sep 87

Date

3637 (10-81)

THE WHITE HOUSE
WASHINGTON

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CABINET AFFAIRS STAFFING MEMORANDUM

Date: 9/4/87 Number: 490,688 Due By: _____
Subject: Economic Policy Council Meeting -- September 10, 1987 - 11:00 a.m.

Roosevelt Room

ALL CABINET MEMBERS	Action	FYI		Action	FYI
Vice President	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEA	<input checked="" type="checkbox"/>	<input type="checkbox"/>
State	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEQ	<input type="checkbox"/>	<input type="checkbox"/>
Treasury	<input checked="" type="checkbox"/>	<input type="checkbox"/>	OSTP	<input type="checkbox"/>	<input type="checkbox"/>
Defense	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Justice	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Interior	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Agriculture	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Carlucci	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Commerce	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Cribb	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Labor	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Bauer	<input checked="" type="checkbox"/>	<input type="checkbox"/>
HHS	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Dawson (For WH Staffing)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
HUD	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Transportation	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Energy	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Education	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
Chief of Staff	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
OMB	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Executive Secretary for:		
UN	<input checked="" type="checkbox"/>	<input type="checkbox"/>	DPC	<input type="checkbox"/>	<input checked="" type="checkbox"/>
USTR	<input checked="" type="checkbox"/>	<input type="checkbox"/>	EPC	<input checked="" type="checkbox"/>	<input type="checkbox"/>
<u>CIA</u>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
EPA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
GSA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
NASA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
OPM	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>
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VA	<input type="checkbox"/>	<input type="checkbox"/>	_____	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS: The agenda and papers for the September 10 meeting of the Economic Policy Council are attached. The meeting is scheduled for 11:00 a.m. in the Roosevelt Room.

RETURN TO:

☒ Nancy J. Risque
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Associate Director
Office of Cabinet Affairs
456-2800
(Room 235, OEOb)

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EXEC
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B-504-15

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THE WHITE HOUSE

WASHINGTON

September 4, 1987

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: EUGENE J. McALLISTER *EM*

SUBJECT: Agenda and Papers for the September 10 Meeting

The agenda and papers for the September 10 meeting of the Economic Policy Council are attached. The meeting is scheduled for 11:00 a.m. in the Roosevelt Room.

The first agenda item will be consideration of possible self-initiation of 301s in the telecommunications area. A general paper discusses interagency deliberation on this matter and ranks ten countries in terms of the restrictiveness of their practices. Separate papers review the current situation in each of these countries.

The second agenda item will be a report from the TPRG on Kansai Airport construction practices, focusing on the options for future U.S. action.

The third agenda item will be a report from the TPRG on Korean insurance practices, recommending the self-initiation of a Section 301 action.

The fourth agenda item will be a review of section 301 developments including cases which will require future Council action.

Papers for all four agenda items are included.

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ECONOMIC POLICY COUNCIL

September 10, 1987

11:00 a.m.

Roosevelt Room

AGENDA

1. Telecommunications: Possible Self-Initiation of 301s
2. Japan Kansai Airport Construction Practices
3. Section 301 Action Against Korean Insurance Practices
4. Section 301 Developments

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OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

September 3, 1987

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM THE TRADE POLICY REVIEW GROUP

SUBJECT: TELECOMMUNICATIONS: POSSIBLE SELF-INITIATION OF 301s

Issue

The Economic Policy Council has requested that we determine whether certain countries' telecommunications trade and investment practices would be actionable under Section 301 of the Trade Act of 1974, in preparation for its review of possible self-initiation of 301 investigations. In preparing this issue for EPC review, the TPRG has ranked the countries under review in terms of the restrictiveness of their practices.

Background

o U.S. industry does not support initiating any section 301 complaints on telecommunications at this time. As indicated in a meeting with industry reps on August 24, this is true both of those who support and those who oppose telecom legislation.

-- The former believe current legislation contains a more positive, clear and productive approach.

-- The latter are concerned that initiation of 301s at this time will be seen as "caving in" to Congressional pressure and are concerned about possible limitations on access to imported equipment.

-- Current telecom legislation requires the Administration to develop objectives for telecom with industry input, enter into negotiations, and achieve results or retaliate, generally within three years.

o The TPRG reviewed 12 countries to determine their significant barriers, the extent to which practices are unreasonable within the meaning of section 301, the estimated effect of barriers, the history of consultations, and advantages and disadvantages of self-initiation. Individual country reviews are attached.

o The following common themes became apparent in the technical review at the staff level leading up to the TPRG discussion:

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-- The Administration's willingness to self-initiate would demonstrate high priority attention to telecommunications, partly in response to Congressional and private sector concerns.

-- On the other hand, self-initiation could be counter-productive, since many countries are taking or contemplating steps toward liberalization, and the more confrontational approach might reverse this trend. Moreover, taking action against any EC Member State in particular would enable that country to shift the locus of negotiation to the Commission, which has no competence over national PTTs.

-- For most countries studied, it could be argued that their practices are unreasonable within the meaning of section 301, based on lack of national treatment and/or of fair and equitable market opportunities. Therefore, they would be actionable under section 301 if they burdened or restricted U.S. commerce. However, since the U.S. has one of the very few open telecommunications markets, it may be inappropriate to label widespread, common foreign practices as unreasonable.

-- Most of the burdensome and potentially unreasonable practices are nevertheless not inconsistent with countries' GATT obligations. Were we to retaliate ultimately by restricting imports of goods, we would likely violate our own GATT obligations, leaving ourselves open to possible GATT sanctions.

-- For countries with which we have treaties of friendship, commerce and navigation (FCN) (e.g., which includes all countries reviewed, except China and Brazil), those accords probably do not provide an international legal basis for action, since communications enterprises are largely excluded from the key establishment article in such treaties. Were we to retaliate in such instances, we could also be accused of breaching the MFN obligations of the FCN.

-- It is not clear that we have the necessary leverage through taking or threatening 301 action on telecom trade to open foreign markets. Countries that have the most restrictive practices (e.g., Germany) may be net telecom importers from us; countries that have a telecom surplus (e.g., Japan) may have relatively more open policies. Thus, we would probably need to restrict import access on non-telecom items if retaliation were necessary.

-- We need to assess each case carefully in light of current bilateral and multilateral efforts. Self-initiating in telecommunications could "poison the well" for achieving positive results in other on-going issues (e.g., Airbus).

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Moreover, initiation of 301s could result in overt or covert retaliatory action against U.S. firms based overseas.

-- Achieving only national treatment may be a Pyrrhic victory in countries with telecommunications monopolies; in those cases, improvements in market access should be sought.

Interagency Consideration

The Trade Policy Review Group (TPRG) reviewed a number of options regarding self-initiation.

o There was considerable skepticism about self-initiating 301 action at this time, particularly in light of private sector opposition. At the same time, there was concern that our current low profile strategy on telecommunications will continue to yield only minimal results. Consequently, a more aggressive strategy short of self-initiating a 301 is needed, although no specific suggestions for such a strategy were put forward. It was also agreed that a decision not to take 301 action at this time should not preclude possible self-initiation at some future date, and that we should send a clear signal to our trading partners that future 301s are not precluded.

o The TPRG also considered self-initiation only against Germany. Agencies generally agreed that Germany's practices are among the most restrictive and its market among the most significant. However, it would be difficult to justify singling out Germany's practices, since they are no more egregious than certain other countries' barriers. It was also pointed out that there are certain powerful forces for liberalization in Germany that could be undermined by self-initiating a 301 at this time. Moreover, there are certain non-trade factors with regard to Germany that must be considered at present (i.e., Germany's role in U.S./Soviet arms negotiations).

Country Ranking

To facilitate EPC consideration of individual countries, the TPRG ranked them broadly according to the restrictiveness of their practices. At the same time, the TPRG believes the EPC should take certain other factors into account in any final "accounting" of countries, including the significance of the market, the relative importance of telecommunications on our bilateral trade agenda, and the chances for the success of a section 301 effort. Countries are listed below in broad categories of restrictiveness of barriers. China and India, although reviewed by the TPRG, are not included on the table, because they were considered entirely inappropriate for any 301 action.

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COUNTRY-RANKINGCountryOther ConsiderationsMost Restrictive

Brazil	Would complicate efforts to conclude earlier self-initiated 301 (informatics). Slim chances for success.
Germany	Long history of unsatisfactory consultations. Should consider relative to importance of non-trade issues at this time (i.e., arms negotiations).
Korea	Consultations only began within past year; going fairly well. Other priority issues "on our plate."

Less Restrictive

Austria	Non-EC European country (therefore no "competence" problem). But, have held no consultations.
France	Has made some moves toward liberalization.
Italy	Not as large as other EC markets and not as influential in policy-setting. Actual practices more liberal than regulations.
Spain	New law being considered would be step in right direction, although not sufficient.

Least Restrictive

Netherlands	Although existing system is undesirable, considering legislation that would make significant improvements.
United Kingdom	U.K. telecom system is the most liberal in Europe.
Japan	From regulatory standpoint, relatively open, although real market access improvements have not occurred to the extent we would like. \$60 billion trade surplus with us should be considered.

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SECTION 301: TELECOMMUNICATIONS

COUNTRY PAPERS ATTACHED

1. Austria
2. Brazil
3. China
4. France
5. Germany
6. India
7. Italy
8. Japan
9. Korea
10. Netherlands
11. Spain
12. United Kingdom

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~~CONFIDENTIAL~~Austria: Possible Self-Initiation of Telecom 301

I. Technical Criteria

A. Significant Barriers to Trade and Investment

1. Terminal Equipment

The Austrian PTT defines the minimum standards which must be met by telecommunications equipment utilizing the public switched network for both basic and enhanced services. The first telephone instrument and the first telex machine with each subscriber must be leased from the PTT. All other equipment connected to the public network, or to private telecommunications systems which use channels leading to the public networks, must be licensed for use by the PTT.

Some observers believe that the PTT is becoming more liberal in approving telecom equipment, as the result of strong industry pressure. The following examples demonstrate the extent to which the Austrian terminal market is open to competition:

Cordless Cellular Phones: The PTT has approved cordless cellular telephones for sale by private companies.

Terminals: Any certified terminal may be attached to leased lines and to the switched network. Any certified terminal may be attached to the videotext system, so long as a PTT-supplied modem is used. This is a recent change. Formerly, the PTT only permitted the MUPID interactive terminal, whose development was subsidized by the GOA.

Modems: On most leased lines¹, network users can use any modem offered by a private company, so long as it is approved by the PTT. On the switched network, competition is permitted for low speed modems (under 2400 BTS). A PTT supplied modem is still required for higher speed transmission and for all terminals attached to the videotext system.

Telex: The first telex machine must be supplied by the PTT. For subsequent machines, subscribers can now use any compatible telex/computer terminal. Formerly, only PTT-approved telex equipment was allowed.

PBXs: Generally PBXs can be obtained competitively for use on both leased lines and the public switched network. The only exception is small PBXs in support of the public switched network

¹The exception is modems for use on class DDL leased lines which are used for analog data transmission. Modems on these lines must be supplied by the PTT.

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which must be supplied by the PTT.

PTT standards policies are used as industrial policy to encourage technological industrial advances by Austrian-based manufacturers. This backfired in the case of the MUPID terminal. As mentioned above, the GOA backed the MUPID as a "smart" terminal for the Austrian video text system. The GOA adopted the "C-two" CEPT standard for the terminal, which is more advanced, but also more expensive, than the "C-zero" system adopted in Germany. The result was that the MUPID is confined to the small Austrian market and does not sell in Germany. This makes it impossible for the MUPID producers to make a profit.

Currently, only companies authorized by the postal administration are permitted to install communications equipment. By 1988, subscribers will be able to buy peripheral equipment with a universal plug which they can attach to the switched network themselves. The PTT will have a monopoly on distribution of the new universal plug and will release it only to manufacturers of certified equipment.

2. Network Equipment

The PTT also uses procurement policies as part of its industrial policy. The PTT procures almost all of its equipment for the public switched network from four companies with large manufacturing facilities in Austria: Siemens, Alcatel (formerly ITT), Kapsch, and Schrack (the latter two are private-owned Austrian firms). These four supply also supply a large portion of other telecom equipment.

The U.S. Embassy notes that entry into the equipment market by foreign firms is extremely difficult if not undertaken through joint manufacturing with well-established Austrian companies or through the establishment of Austrian production subsidiaries.

3. Enhanced Services

a.) Enhanced Services on the Public Switched Network

Private companies may offer enhanced services over the public switched network if the PTT approves the service in advance. Generally, private companies chose not to offer enhanced services over the public network. This is because the profitability in enhanced services lies primarily in creating a dedicated network of leased lines.

b.) Enhanced Services on Leased Lines

Timesharing and remote batch processing: This type of enhanced services is permitted over leased lines. If the services are offered within a single company, a base rate is charged. There

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are no volume sensitive charges. If these services are offered between two different companies over leased lines, the base charge for the leased lines is increased by 50 percent.

Information type services, data base access and videotext: These services are subject to the same treatment as timesharing and remote batch processing. That is, these services can be offered to third parties, provided that the lessor pays a 50 percent surcharge on the leased lines.

Value-added enhanced services such as electronic mail, protocol conversion: A single company can provide this type of service between its own offices over leased lines, but it cannot offer such services to other companies.

c.) Other Regulatory Restraints

The major restraints which prevent private companies from offering enhanced services in Austria are those described above. However, even if those restrictions were removed, the Austrian PTT, like the German Bundespost, maintains a number of restrictions on the use of leased lines which could prevent private service suppliers from gaining market access and competing in the future. The Austrian PTT does not allow its subscribers to tie leased lines to the switched network. Private subscribers are not permitted to do the following over leased lines: subchanneling, speed conversions, data over voice, and voice over data. No line sharing is permitted between two different enterprises.

d.) PTT Services: Telex and Electronic Mail

The PTT handles international telex and data transmission service to other western nations. Radio Austria, a government-owned company operating under PTT license, handles electronic mail to all foreign destinations except the FRG, Switzerland, and Liechtenstein. For these three countries, electronic mail is administered by the PTT. Private companies are allowed to set up electronic mail services using the public switched network. They are not permitted to offer electronic mail over leased lines.

B. Unreasonableness of Barriers

None of the practices described above are GATT or GATT-Code illegal and thus none are "unjustifiable" within the meaning of 301. The practices could be considered "unreasonable" within the meaning of Section 301.

Standards: Austrian standards go beyond U.S. criterion of "no harm to the network." Foreign suppliers have little or no access to the Austrian standards development process. In contrast, the U.S. has an entirely open standards development process, but it is the only country in the world to have such an open process.

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Testing Certification, and Attachment Procedures The requirement for PTT approval for all equipment attached to the network is a major anticompetitive aspect of the Austrian market. The PTT's role as operator, competitor, and approval authority is inconsistent with the concept of an open market. In the U.S., the FCC is responsible for granting equipment approvals and the Bell Operating companies must separate their operation of the network from their competitive functions.

The Austrian refusal to recognize foreign test data and manufacturer self-certification are also trade barriers which do not exist in the U.S.

Network Procurement: The PTT's preferential procurement policies are a major disincentive to new suppliers and to U.S. investment in the Austria. However, the PTT's procurement of network equipment almost entirely from Austrian sources is not GATT illegal because PTTs were not covered by the Government Procurement Code.

Enhanced Services: PTT regulations of leased lines are a major disincentive to private companies wishing to offer value-added services. The major barrier is the prohibition on the use of leased lines to provide value-added enhanced services between different companies. While this prohibition does not exist in the United States, the Austrian system, patterned on the German model, is the norm in Europe. Other potential barriers include the PTT's ability to deny approval for peripherals used to provide enhanced services. Also, there are no legal constraints on the PTT to prevent it from using its monopoly profits on basic services to cross-subsidize its competitive offerings of enhanced services.

C. Burdensomeness of Barriers

We do not have an estimate of the size of the Austrian market for telecommunications. It is one of the smaller European markets. Some observers would equate it with the Dutch market (\$600 million in 1986). U.S. trade with Austria in telecommunications is small. U.S. exports to Austria in 1986 were \$32,000, down from a peak of \$491,000 in 1984. Exports for 1987 through June were \$8,000. Austrian exports of telecom equipment to the U.S. were \$69,000 in 1986 and \$15,000 during the first six months of this year. If Austrian trade barriers were removed, U.S. sales of telecommunications equipment and services in Austria could increase significantly.

D. Status of Consultations

The USG has not held any bilateral discussions with the Austrians on telecommunications trade policies. If we were to initiate a 301 action against Austria, the GOA might complain that they were

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not given the same opportunity to discuss their telecom policies as we have given other trading partners through MAFF and/or other telecommunications discussions. .

U.S. concerns about Austrian standards for terminal equipment have been listed in the National Trade Estimates for the last three years

The U.S. Embassy regularly reports on the status of Austrian telecommunications policies and their trade effects. Certain U.S. companies have given us information on enhanced services which conflicts with some of the Embassy's reporting.

II. Advantages and Disadvantages of Self-Initiation

A. Advantages

- Sends a message to the German Bundespost that we are prepared to take action on Austrian telecom practices which largely parallel German policies. The advantage to moving against Austria first are two fold. First, it allows us to send a message to the Germans without attacking them during the sensitive period while they are considering the Witte Commission's recommendations for liberalization of their telecommunications sector. Second, U.S. companies would be less exposed to potential retaliation in Austria than in Germany. (Note possible exception: cellular phones in Austria are supplied primarily by Motorola.)
- Could capitalize on indications of discontent with Austrian telecom practices within the Austrian business community.
- Gives the EPC an alternative European target for a 301 which does not have the problem of involving the European Community Commission.

B. Disadvantages

- Would draw GOA criticism for discriminatory treatment, if we were to initiate a 301 before at least an initial round of bilateral telecom discussions, as we have had with other trading partners.
- Might cause the Austrian PTT to take actions to block U.S. enhanced service suppliers from serving the Austrian market by denying its approval for their peripherals.
- Could provoke negative reactions which might slow the liberalization process in Austria.
- Might leave the USG subject to the criticism of wasting its 301 ammunition on a small market which does not have the

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scale to interest many U.S. companies in making the investment necessary to sell in Austria.

- Could be subject to the criticism that a 301 case against Austria is misdirected. U.S. companies have shown little interest to date in this small market. Some believe that taking action against Austria, would have little or no effect on German policymakers.

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TELECOMMUNICATIONS: BRAZIL

Any consideration of Brazil's policies and practices in the telecommunications area and possible U.S. responses must take into account the recently suspended self-initiated Section 301 action against the Brazilian informatics law.¹ Many of the barriers U.S. companies face in trying to sell telecommunications equipment and services in Brazil are based on the same principles of market reservation and protection of domestic production for any good containing a "digital technique" which have proven so burdensome for U.S. computer and related companies. Moreover, to the extent that we have accepted certain GOB policies, like time-limited market reserve, for informatics, we will find it difficult to argue for a more liberal standard for telecommunications.

I. Technical BarriersA. What are the significant barriers to trade and investment?

Access to the Brazilian telecommunications market is virtually closed to foreign suppliers as a result of government purchasing policies, market reserve and import restrictions. The restrictions in the telecommunications area predate those imposed on the computer-related industries (i.e., on anything containing a "digital technique") through the informatics policy. In 1978, the Ministry of Communications enacted Directive 622 to purchase central telephone processing equipment only from majority-owned Brazilian firms. The government-owned holding company, Telebras, may only procure foreign equipment when the product is not available from Brazilian manufacturers or when delivery time or other technical considerations make domestic sourcing impractical. Directive 622 also imposed uniform Telebras specification requirements and restrictions on the number of suppliers per product line.

Under Regulation 622, Brazilian control of voting stock was required, but there were no specific regulations on capital stock because of Telebras' desire to increase the capitalization of the telecommunications equipment sector. With the implementation of the 1984 informatics law, however, any new investment or new projects by existing investors must have the 70 percent Brazilian-owned capital stock requirement provided for in that law. In addition, decisionmaking agencies have great discretion in approving these joint ventures.

Domestic equipment manufacture is also protected through high tariff rates, which range from 30 percent to 185 percent, strict import licensing requirements, tariff surcharges, local content

¹Although the investment portion of our complaint remains pending.

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requirements and financial transaction taxes based on the value of foreign exchange necessary for the purchase. Generally, tariffs and other barriers are lower for sophisticated goods not produced locally (consistent with the GOB's general application of the Law of Similars). Moreover, U.S. exporters indicate that tariffs are not the major barrier to telecommunications imports. As we have seen in other cases, the GOB is willing to waive those duties in cases where it deems the import essential. The GOB also forbids payment of royalties from foreign subsidiary to parent if that subsidiary is producing Telebras-preferred equipment.

Regulation 661 of August 1975 mandated the development of a family of time-division switching equipment (Digital SPC) by the Research and Development Center of Telebras (CPqD) and required that this equipment be employed by the national telecommunications systems as soon as it was available. Telebras hopes that these national systems will be the backbone of its telecommunications systems in the future, replacing foreign switching systems currently produced by Brazilian companies associated with Ericsson, Siemens and other foreign firms.

The GOB recently placed fiber optic production under the market reserve of the informatics law. Therefore, important investment and import restrictions now apply in that sector.

Regarding services, currently all processing of data must be done in Brazil. Companies that wish to sell such data in Brazil must do so through a Brazilian firm. All international data communications links must be approved by the Special Secretariat for Informatics (SEI), with criteria for approval of links not specifically defined. Moreover, the approval of links is granted only for limited periods of time. Under the 1985 Informatics Law's authorization to the GOB to "establish standards for the flow of trans-frontier data and to award channels or means for data transmissions for interconnection with data banks and nets abroad," restrictions could be further tightened.

Brazil's TBDF policy is most restrictive for commercial uses of information flows. The commercial processing of data abroad is explicitly prohibited. Data access for commercial purposes is allowed only in cooperation with Brazilian institutions provided that a copy of the data, to be updated periodically, is kept in Brazil. Restrictions on intra-corporate data flows are less explicit. For intra-corporate data flows are less explicit. For intra-corporate data access, a copy of the parts "necessary for local use" must be kept in Brazil when possible. Intra-corporate links for data processing are allowed if no "reasonable" local alternative exists.

The provision of value added services is also restricted.

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B. Basis on which to consider these barriers unreasonable

Like the more recent, and all-encompassing, informatics policy that was the subject of the USG's 1985 self-initiated 301 complaint, barriers in the telecommunications area could be considered unreasonable and a burden on U.S. commerce. However, it is not clear that telecommunications barriers are unreasonable under the section 301 standard. As a matter of U.S. domestic law, Brazil's government procurement practices are unreasonable because they deny national treatment. Similar restrictions on investment and inadequate intellectual property protection in the informatics area have already been determined by the President to be unreasonable. Therefore, these practices seem actionable, since they burden U.S. commerce. However, there is no GATT basis for challenging these practices. Therefore, Brazil could challenge under the GATT any U.S. countermeasures against imports of Brazilian products (as Japan is doing in the semiconductor case. Brazil's restrictions, e.g., local content requirements, appear to go substantially beyond those imposed by other developed and developing countries we have reviewed. Brazil is not a signatory to the GATT's Government Procurement Code.

C. Effect of barriers on competition

In overseas markets. The Brazilian telecommunications market is estimated at \$576 million. In 1985, Brazilian imports of telecommunications equipment approximated \$74 million, about 15 percent of total purchases of these products. The major suppliers were the United States (33 percent), Japan (25 percent), the United Kingdom (7.5 percent) and Germany (7 percent). Brazil exported \$272 million in telecommunications equipment in 1985, a two percent increase over 1984.

Overall, opportunities for foreign investors and exporters to Brazil in the telecommunications sector are quite limited. In the telephone equipment area, the opportunities are virtually non-existent. In other areas, such as telex equipment, the investment possibilities for foreign companies are largely restricted to licensing and joint ventures. Market opportunities are restricted to sophisticated equipment incorporating the latest technology, equipment not locally manufactured or assembled in sufficient quantities to meet demand, and one-time-only sales. U.S. suppliers have competed most successfully in test instrumentation, radio communications and radiotelephone equipment, data communications, and radio and television broadcasting and studio equipment.

Brazilian trade and investment policies and practices in the telecommunications area appear to have had a deleterious impact on U.S. commercial interests. The GOB's buy-national telecommunications program has led many foreign-based companies to divest entirely or take on Brazilian-majority partners. For

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example, as of 1980, the central telephone exchange business was dominated in terms of units by Siemens (30 percent of the 2,460 central automatic telephone exchanges), Ericsson do Brasil (23 percent), Philips Electronica do Nordeste (14 percent), ITT's Standard Electrica (14 percent), NEC do Brasil (10 percent) and others (9 percent). By 1982, however, as a result of GOB pressure and restrictions, these foreign manufacturers had transferred the control of their subsidiaries to Brazilian shareholders. U.S. firms selling telecom equipment and services, including GTE, appear to have little or no interest in fighting current barriers to penetrate the Brazilian market. (AT&T and IBM are extremely interested in selling computer hardware and software, however, despite the current informatics-related restrictions.)

Brazil is not an important world supplier of telecommunications equipment and services. The effects of its telecom programs, including CPqD's research and development subsidies for Brazilian companies, on the competitiveness of those firms attempting to operate in third markets is therefore small.

In the U.S. market. Although Brazil supplies some computer hardware to the U.S. market, it is not a major player in the telecom area.

Value of damage. Particularly in light of U.S. firms' reduced presence in the Brazilian telecom market during the 1980s, no estimates are currently available on the dollar value of damage resulting from telecom restrictions. Lost market opportunities and the adverse impact on U.S. subsidiaries in Brazil which use telecom goods and services (e.g., financial institutions) could be great.

D. Status of Consultations

The United States and Brazil have not held consultations to address telecom trade and investment barriers specifically. Moreover, while many of the trade and investment barriers affecting telecommunications are identical to those in the informatics area and were therefore the subject of intensive discussions and 301 action, our subsequent negotiations with the GOB did not eliminate telecommunications market restrictions per se. We have not held or scheduled Market Access Fact-Finding discussions on telecom with the GOB.

III. Advantages and Disadvantages of Self-Initiation

A. Advantages

- o Shows the Administration is serious about pursuing telecommunications trade and investment objectives.
- o Would be a reasonable "follow-on" to the informatics 301, since the restrictions are similar and equally

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burdensome on U.S. commerce.

- o Would make clear to the GOB and other developing countries, particularly in Latin America, that telecom is a key sector and that the USG will not be "scared off" by the difficulties we encountered in attempting to resolve the informatics dispute.

B. Disadvantages

- o Self-initiating another 301 case at this time could seriously jeopardize progress we have achieved to date on the trade and intellectual property-related aspects, in particular, in the informatics case.

- o A self-initiated telecom case could jeopardize any hope for progress (however slim) in the current pharmaceutical 301 case.

- o Highlighting telecom could force a national debate on the subject in Brazil and result in even tighter restrictions and formal incorporation of these barriers into the constitution now being drafted.

- o Self-initiating another 301 case against Brazil could enable the GOB to rally other LDCs around Brazil in the GATT and elsewhere, by claiming we are singling out that country for especially tough treatment.

- o GOB could claim it was unfair for USG to self-initiate a 301 when no bilateral consultations have been held on this issue specifically.

- o Were we to limit our complaint only to those practices that have not been covered in the informatics 301 case, we would greatly diminish the value of any positive outcome from such a case.

- o Prospects for a positive outcome are not great .

Drafted by: USTR: M. Barell 8/17/87, rev. 8/24/87, 8/31/87

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FRANCE

I. Technical Criteria

A. Significant Barriers

The U.S. government has a number of market access concerns with regard to the telecommunications environment in France. The primary concern is that, at least at present, there is no institutional separation of the regulatory and operational responsibilities of the French telecommunications administration. The Direction General des Telecommunications (DGT) is part of the Ministry of Posts and Telecommunications. Therefore, there is a fundamental question of whether U.S. firms can compete fairly in an environment in which the DGT not only retains a monopoly over telecommunications services, but can effectively operate as both participant and referee. The U.S. government also has more specific concerns, however, in each of the following three areas: (1) terminal equipment; (2) network equipment; and (3) services.

1. Terminal Equipment

a. Testing and Certification

As is the case in many other European countries, the standard for terminal equipment registered in France exceeds the "no harm to the network" standard adopted by the FCC in the United States. This may serve to limit access by U.S. terminal equipment manufacturers to the French terminal equipment market. Moreover, testing of customer premises equipment must be performed by the Centre National D'Etudes (CNET), which is part of the DGT.

Certification of customer premises equipment includes: (1) type approval for both technical and functional specifications and (2) assurance that the equipment will be manufactured in France within a certain time frame. Testing of installed equipment is required in limited cases. Equipment manufacturers must also assure the availability of follow-up service and maintenance for their equipment sales. In addition, financial liability of the manufacturer must be adequately accounted for.

2. Network Equipment

The French telecommunications market is relatively closed to U.S. suppliers of network equipment. U.S. government concerns include: (1) rigid product standards; (2) discriminatory procurement; and (3) "Buy French" policies that serve to exclude foreign suppliers. Simply put, the DGT procures almost all network equipment in France through a closed bidding process that favors French manufacturers.

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Procurement of some equipment is open to competitive bidding, but it is almost always limited to products that are not produced in France. Therefore, while the French government contends that its telecommunications market is among the most open in the world, Cie. Generale d'Electricite (CGE), whose acquisition of ITT's worldwide telecommunications operations gave CGE control of the second largest telecommunications company in the world (Alcatel NV), has a predominant share of the French market for important network equipment items, such as switches (reportedly as high as 84% of the switching market). Moreover, the French government decision to select the Swedish firm Ericsson to purchase Compagnie Generale de Construction Telephonique (CGCT), which is expected to provide Ericsson with access to the remaining 16% of the French market for switching equipment, effectively removed the possibility of U.S. access to this market for the foreseeable future.

3. Services

The DGT retains a monopoly over the provision of what the United States would term "basic services." The French government is considering the possibility, however, of separating the regulatory and functional operations of the telecommunications administration and establishing some form of independent oversight over the provision of network services. Nevertheless, the current status even of providers of value added services in France is unclear. While it is our understanding that certain firms may well provide value added services in France, it appears that they do so under a questionable legal or "de facto" status.

DGT officials have told U.S. government officials that the Ministry of Industry, PTT, and Tourism will issue a decree within the next several weeks to establish a legal regime for the competitive provision of value added services. French government officials state that this regulatory decree will distinguish between "telematique" and basic services, with "telematique" services essentially defined as "value-added" services offered to third parties, excluding pure resale and voice services. Furthermore, French government officials suggested that the decree would also distinguish between general and specific telematic services, with general service providers subject to a requirement to obtain a license from the Ministry of Industry, PTT and Tourism. Moreover, both general and specific telematic service providers could be subject to a surcharge of as high as 30% of the charge levied for their leased lines.

B. Basis on Which These Barriers are Considered Unreasonable

1. Terminal Equipment

In the United States, FCC rules provide for the submission of test data for certification of equipment under Part 68 and the testing can be performed within the manufacturer's own laboratory or in independent laboratories, domestic or foreign. Moreover, the FCC processes 95% of all

Part 68 registration applications within two months. Furthermore, FCC requirements are limited to requiring "no harm to the network" and no testing is required for installed equipment. The U.S. government is concerned that French regulations governing the attachment, testing and certification of terminal equipment may prevent, delay or increase the cost of terminal equipment that U.S. manufacturers wish to sell in France.

In discussions in July, however, the DGT officials stated that the French government had abolished the so-called primary instrument requirement. The U.S. experience demonstrates that this constitutes a significant policy change that could lead to greater opportunities for U.S. equipment manufacturers and enhanced service providers. Although the French national standard for terminal equipment and the present failure to accept U.S. test data make the French market for terminal equipment more restrictive than the U.S. market, if one factors the removal of the primary instrument requirement into a comparative assessment, current French regulations would be less restrictive than a number of other markets in Europe, including the Federal Republic of Germany, and might even be considered less restrictive than certain "liberal" countries, such as the Netherlands, which continues to have a primary instrument requirement pending the adoption of new legislation. Therefore, while the French national standard for terminal equipment and the French failure to accept U.S. test data could be considered unnecessary and a burden on U.S. commerce, GOF policies on terminal equipment are, in fact, more liberal than many other European countries. As a result, should a 301 action provoke retaliation under the GATT or the FCN treaty, it might actually serve to close to U.S. equipment manufacturers a market that has been increasingly open to U.S. firms.

2. Network Equipment

The closed procurement practices of the DGT and the absence of an opportunity to participate in the French standards setting process effectively preclude U.S. participation in the French telecommunications network equipment market, except to the extent that such equipment is not available in France. The DGT, however, as is the case with other government-owned PTTs, is exempt from the GATT Procurement Code. Therefore, although extending code coverage to PTTs is a major U.S. objective in the current GATT round, present French procurement practices do not constitute a violation of international trading obligations or any other international laws.

The non-transparent standards setting process and closed procurement process could be considered to discriminate against U.S. firms, and deny them national treatment. The difficulties created for U.S. switch manufacturers could in turn be considered a burden on U.S. commerce. However, the DGT is exempt from Procurement Code obligations, and it could be argued that signatories to the Code implicitly accepted restrictive PTT

practices. Again, initiation of a 301 action could result in retaliation under the GATT or FCN treaty.

3. Value Added Services

The U.S. government is also concerned that the absence of a clear legal regime for the provision of value-added services in France, and the possibility that certain U.S. value-added service providers could be subject to licensing requirements and large surcharges, may serve as a barrier to the provision of value-added services in France. While such barriers do not represent a violation of any international or bilateral obligations, the U.S. government believes that such French government policies may limit the ability of U.S. firms to compete in France and internationally.

It is difficult to make an assessment of the reasonableness of current GOF policies regarding value added services in view of their "de facto" status. Moreover, although U.S. industry has concerns with several of the requirements that the DGT has proposed for a forthcoming decree establishing a legal regime for the competitive provision of value added services, we have not received confirmation that this decree has been approved at the ministerial level. Absent such confirmation, and a text of the decree, it is not possible to assess the reasonableness of future French policies for the provision of value added services in France.

C. Effect of these Barriers on Competition

1. Terminal Equipment

The effect of these French policies vary across the three sectors discussed. The size of the French telecommunications equipment market was estimated to be \$5.0 billion in 1986. The customer premises equipment market, an estimated \$892 million market, is among the more competitive CPE markets in Europe, with the DGT purchasing only about 10% of the CPE sold in France in 1986. French testing and certification requirements can result in delays, however, that may serve to reduce the level of U.S. participation in this market.

2. Network Equipment

The network equipment market, an estimated \$3.7 billion market, is effectively closed to U.S. network equipment suppliers. U.S. exports in 1986 accounted for only 1.1 percent of all telecommunications equipment procurement in France.

3. Value Added Services

French regulations governing the provision of value-added services may serve to limit U.S. firms from freely establishing French and international networks. It has been estimated, however, that the value-

added services market in France at present is only \$100 million, with public access to some 3,400 data bases.

D. Status of Consultations

In July, FCC Chairman Dennis Patrick led an interagency delegation to Paris. U.S. industry officials in Paris told this interagency delegation that it is unlikely that the French government will pass a major new law on telecommunications before the French presidential elections next spring. Therefore, consideration of major changes, such as the separation of regulatory and operation functions and the possibility of privatization of the DGT, is unlikely in the near future. The French government has shown interest, however, in moving forward on modest measures to liberalize the provision of value-added services in France, to permit a somewhat more open approach for the certification of terminal equipment, and to provide for competition in the provision of cellular services.

II. Advantages and Disadvantages of Self-Initiation

A. Advantages

1. Might encourage the GOF to accelerate liberalization.
2. France is a significant market in Europe, and one where the U.S. has had serious problems. A 301 action would serve as a clear illustration of U.S. resolve to deal aggressively with such problems.
3. French policy changes as a result of a 301 action might lead to greater liberalization in other countries in Europe.
4. Would respond to Congressional concern over the loss by AT&T of the opportunity to purchase CGCT.

B. Disadvantages

1. The U.S. government has limited leverage to apply to the French in telecommunications.
2. With the approaching presidential elections, the French government is unlikely to be in a position to, or wish to, respond favorably to the initiation of a Section 301 action.
3. It appears that the present conservative leadership would like to liberalize the telecommunications sector over time, but is faced with political opposition by the DGT and the socialists that would be strengthened by the initiation of a 301 action.
4. The initiation of a section 301 action might divert attention to the symptoms of our concerns and therefore not promote broader

objectives --that is, the transfer of regulatory authority to an independent regulatory body, the promotion of a fair and impartial administrative process and consequent substantive changes over time that facilitate the entry of U.S. terminal equipment manufacturers and value-added service providers.

5. A 301 action now would leave the U.S. open to charges that such action is an unwarranted act in retaliation for losing what the French characterize as a fair contest for CGCT.

6. A 301 action could cause a withdrawal of goodwill that would jeopardize U.S.-France relations in a variety of areas, including ongoing negotiations in other sectors.

drafted by: R.Milkman/FCC/632-4047 rev. 8/24/87; rev. 8/31/87

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Section 301 Analysis: Germany

I. Technical Criteria

A. Trade & Investment Barriers

1. Terminal Equipment

o Standards

The Bundespost impedes access to the German market by imposing regulations that go beyond ensuring against harm to the network. These regulations are intended to assure a high level of performance. In addition, the German definition of terminal equipment is unnecessarily broad in order to maximize the extent of the Bundespost's monopoly. Under the German system, the first instrument on each customer's premises must be owned and maintained by the Bundespost. In effect, this discourages or prohibits the installation and use of "intelligent" terminal equipment at the customer's premises.

o Other Bundespost Procedures

Draft Bundespost regulations for attaching terminal equipment to the network are not notified to the GATT or subject to comment from suppliers as required by the GATT Standards Code. In addition, the Bundespost does not recognize foreign-generated test data, nor does it permit manufacturers' self-certification. The Bundespost also fails to allow minor changes in certified equipment without requiring recertification, and it mandates unnecessary maintenance and installation requirements.

2. Network Equipment

o Procurement Procedures

Bundespost procurement procedures do not allow fair and open competition by interested foreign suppliers. The Bundespost makes long-term contracts with no more than two

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suppliers, preferably suppliers with manufacturing facilities in the FRG. Central-office switching equipment has never been purchased from a non-German manufacturer.

o Specifications Development Process

Foreign suppliers are not allowed the same access to the Bundespost specifications development process as are German suppliers, who have preferred access to Bundespost procurement plans and related technical information. This is a denial of competitive opportunities comparable to those available in the U.S.

3. Value-Added Services

Volume-sensitive pricing of leased lines is at some of the highest rates in Europe and is applied to competitors of the Bundespost but not the Bundespost itself. Despite German claims that leased line usage would be liberalized when volume-sensitive pricing was introduced, certain restrictions remain on the use of leased lines connected with the public switched network.

B. Possible Unreasonableness of These Barriers

Many of the telecommunications policies and practices of the German government run counter to international practices and trends, as evidenced by practices in the U.S., Japan, Canada and the United Kingdom, as well as EC Commission proposals. The following discusses whether these German practices could be considered unreasonable under the legal requirements of Section 301, in that they deny national treatment and/or fair and equitable market access to U.S. firms.

1. Terminal Equipment

o Standards

German performance criteria go beyond the "no harm to the network" criteria adopted by the U.S., Japan, Canada, and included in the Netherlands draft telecommunications law. The no harm to the network criteria allows market forces, rather than the network

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operator, to decide which terminal equipment best satisfies the customer's requirements. The EC Commission seems to support the U.S. approach; for example, one direction of EC policy on terminal equipment is "gradual but complete opening up of the market to competition." Therefore, when compared to the standards of a number of other developed countries, the German criteria deny U.S. firms fair and equitable market access, and could be considered unreasonable. However, it should be noted that Germany's stricter standards are not in violation of its Standards Code commitments.

o Standards Development Process

Foreign suppliers have little or no access to the German standards development process. U.S. standards development and other regulatory procedures allow the participation of all interested parties, whether domestic or foreign. Changes in U.S. standards are notified to the GATT and subject to comment from all interested parties. Therefore, German standards setting policies deny U.S. firms national treatment and fair and equitable market access, and could be considered unreasonable. However, it should be noted that, although Japan's standard setting process is more open than Germany's, most countries do not permit foreign suppliers access to the standards development process. Also, Germany's standards development procedures, with the possible exception of its failure to notify the GATT of changes in standards, are not in violation of its Standards Code commitments.

o Testing, Certification, & Attachment Procedures

Unlike the U.S. and Japan, Germany fails to recognize foreign generated test data, permit manufacturer's self-certification, or allow the free market to determine maintenance and installation requirements. These policies deny U.S. firms national treatment and/or fair and equitable market access, and could therefore be considered unreasonable. However, it should be noted that most developed countries have restrictive policies

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in these areas.

2. Network Equipment

o Procurement Procedures

The Bundespost's preference for two domestic suppliers is in contrast to the open and competitive procurement procedures of most USG agencies and all RBOCs. Therefore, restrictive German procurement requirements deny U.S. firms national treatment and fair and equitable market access. However, the Bundespost is exempt from Procurement Code obligations; it could be argued by the Germans that this exemption represents an implicit acceptance by all signatories of restrictive PTT procurement practices. Also, the U.S. is the only developed country to have such fair and open procurement procedures for network equipment.

o Specifications Development Process

Unlike the civilian USG specifications development process, the German process does not allow foreign suppliers the same access as domestic suppliers. In the U.S., foreign suppliers are allowed access to U.S. network operators' specifications development process, which is facilitated by Bell Communications Research. Therefore, the German practice denies U.S. firms national treatment and fair and equitable market access, and could be considered unreasonable. However, it should be noted that most countries do not permit foreign suppliers access to the specifications development process. Also, Germany's specifications development procedures are not in violation of its Standards Code commitments.

3. Value-Added Services

o Leased-Line Pricing

The Bundespost requires private value-added service vendors to pay volume-sensitive prices that are some of the highest in Europe and that can exceed prices under a flat rate system. This discourages foreign firms from investing in Germany by increasing the cost

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of their operations there. In addition, the Bundespost does not charge itself the same volume-sensitive prices, putting private vendors of value-added services at a handicap in competing with the Bundespost's own value-added services. In contrast, cost-based leased-line pricing, which is based on the cost to the network operator of installing and maintaining the line, and is not affected by the volume of traffic using the line, is available at flat rates in the U.S. and most other developed countries. Private vendors in the U.S. pay the same flat rates as network operators. Therefore, Germany's pricing practices deny U.S. firms fair and equitable market access, and could be considered unreasonable.

o Usage Restrictions

Germany continues to restrict third party usage of leased lines, even after introducing volume-sensitive pricing, which was intended to serve the same purpose as the restrictions. In contrast, the U.S., the UK, and Japan have no restriction on third party usage. Furthermore, the EC Commission has stated that its objective is the free provision of all services, including value-added services, within member states. Therefore, Germany's restrictions deny U.S. firms fair and equitable market access, and could be considered unreasonable. However, it should be noted that many developed countries continue to restrict third party access to leased lines.

o U.S.-FRG Treaty of Friendship, Commerce and Navigation (FCN)

The FCN (signed in 1954) between Germany and the U.S. guarantees national treatment to U.S. firms in Germany, but specifically exempts the area of "communications" from this guarantee. The FCN may require each parties state enterprises to make procurement decisions solely on commercial considerations, which would make present German telecommunications procurement practices inconsistent with the FCN. However, this provision could be interpreted to provide only MFN rather than national

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treatment, as has Article XVII of the GATT, on which it is based.

The FCN does clearly require MFN treatment of imported goods, unless other treatment is permitted by the GATT. Therefore, any retaliatory action under Section 301 would be inconsistent with the FCN unless it were first sanctioned by the GATT.

C. Burdensomeness of these Barriers

1. In overseas markets

The German market for telecommunications equipment is estimated to have been valued at \$5.5 billion in 1986. Terminal equipment accounts for \$1.4 billion of this and network equipment \$3.7 billion. No estimate is available for the size of the German market for value-added services. U.S. exports of telecommunications equipment to the FRG were valued at \$109 million in 1986, approximately 2 percent of the German market for these products. German trade barriers impose burdensome costs and delays on foreign suppliers and sometimes close the German market entirely for products until they are available from domestic suppliers. For example, the FRG has never imported a central office switch and Germany's radio paging equipment specifications prevent U.S. suppliers from competing in the FRG.

In addition, Germany's protected domestic market could be viewed as providing a subsidy to German manufacturers. This could give German suppliers an advantage in third country markets, to which one-third of German telecommunications production is exported. German suppliers benefit from preferential access to their domestic market, 60 percent of which is accounted for by the Bundespost alone, where prices are considerably higher than elsewhere.

2. In the U.S. domestic market

The U.S. market for telecommunications equipment is estimated to have been valued at \$28 billion in 1986. German market access barriers provide German suppliers a competitive advantage in the U.S. market because German suppliers can rely on the lucrative German market to establish economies of scale and profits.

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3. Value of damage to U.S. industry

No estimate is available concerning the value of the damage to U.S. domestic industry that results from these German barriers. However, there is no question that elimination of these barriers would provide an important stimulus to U.S. industry, which enjoys a comparative advantage in many telecommunications products and in value-added services.

D. Status of consultations

Starting in December 1985, the U.S. has held six Market Access Fact Finding talks with German officials. These talks have concentrated primarily on the eight liberalization measures which the German Government announced in December 1985. There has been some progress to date, for example, authorization of low-speed modem competition, electronic supply of bidding information, an offer to conduct seminars for U.S. industry to explain German procedures and market opportunities, elimination of the 50% domestic data processing requirement, and the drafting of more liberal PBX specifications. We believe that progress has been painstakingly slow. The publication in September of a report by the German Government Telecommunications Commission might speed up liberalization.

II. Advantages and Disadvantages of Self-initiation

A. Advantages

1. Germany is the largest European market in which the U.S. has had serious telecommunications trade problems, and is influential in international telecommunications developments. 301 action against Germany could have a positive affect in opening other markets.
2. We have already discussed our market access concerns during eighteen months of telecommunications consultations with German officials. Little progress has been made. 301 action might indicate that the U.S. will not continue this type of dialogue indefinitely.
3. The historical record shows that Germany responds positively to threats of 301 action. The most recent case involved domestic data processing

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requirements.

4. Siemens and other German investors in the U.S. market would not welcome the trade friction caused by 301, and might pressure the German government to remove the basis for 301 action.

B. Disadvantages

1. The German movement toward telecommunications liberalization has a growing group of supporters. Self-initiation would weaken the position of these supporters.
2. There are strong U.S. business interests in Germany which would oppose 301 initiation, since retaliatory action which would adversely effect their interest could be taken by the German Government.
3. The German Telecommunications Commission report is due to be released in September. It is expected to recommend telecommunications liberalization within the constraints set by history, social requirements and political reality. 301 self-initiation is likely to weaken the chances of the German Government's moving to implement the recommendations made by the Telecommunications Commission.
4. 301 self-initiation would be viewed as highly confrontational by the German Government, could move the locus of this issue to the EC Commission, and could lead to retaliation and counter-retaliation on other sensitive products.
5. Likely to be ineffective: U.S. leverage on Germany is limited because of our bilateral trade surplus in this sector and the strong investment position of German telecommunications companies in the U.S.
6. Confrontation over Germany could negatively affect progress towards liberalization in other European countries as well as terminate MAFF talks.
7. 301 action in regard to telecommunications could detract from our efforts to make progress in Airbus negotiations.

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SECTION 301 ANALYSIS

ITALY

I. Technical Criteria

A. Significant Barriers to Trade and Investment

1. Terminal Equipment

- o Procedures for certification, type approval and attachment to the network are restrictive. These procedures lack transparency, are unusually long, and new approvals must be sought for insignificant product changes.
- o The PTT uses equipment attachment criteria which go well beyond those required to protect the network.
- o The PTT does not accept test data generated by foreign manufacturers or any sources other than Italian PTT testing facilities.
- o Foreign firms must comply with restrictive requirements in order to establish legal representation or distribution networks in Italy.
- o Users, user groups and foreign firms have only a limited ability to participate in the standards-making process.

2. Network Equipment

- o Foreign suppliers are not allowed access to the PTT's specifications development process as are Italian-based suppliers, who have preferred access to PTT procurement plans and related technical information.
- o The PTT does not practice open international competitive bidding for all network equipment. GOI telecommunications procurement entities use private negotiation almost exclusively for major purchases. The PTT allocates market share by selecting from among Italian-based equipment manufacturers for expansion and modernization programs.

3. Value-added Services

- o Value-added services provided by the monopoly cannot be offered by private companies.
- o Service providers in Italy are prohibited from selling leased line space to third parties.

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B. Basis on Which Barriers are Considered Unreasonable

The following discusses whether these practices could be considered unreasonable within the meaning of Section 301, in that they deny national treatment and/or fair and equitable market access to U.S. firms:

1. The policies and practices of the Italian Government and its telecommunications franchisees run counter to international practices and trends as evidenced by regulations in the U.S., Japan, Canada and the U.K., and proposals by the EC Commission. For example, the EC Commission has called for competition in the terminal equipment market and for European PTT's to maintain jurisdiction over a limited number of basic services narrowly defined, as is the case in the U.S.
2. Italy maintains restrictive procedures for certification and type approval, requirements for legal representation and distribution networks, discriminatory procurement practices for network equipment and restrictions on the provision of value-added services.
3. By these standards, Italian practices deny fair and equitable market access comparable to those available in the U.S. and a number of other developed countries, and therefore could be considered unreasonable under Section 301.

Terminal Equipment

- o Unlike the Italian market, the U.S. terminal equipment market is open to sales by foreign suppliers. Restrictions imposed by the GOI on the purchase of terminal equipment effectively deny national treatment. It should be noted that the Italian PTT is exempt from the GATT Government Procurement Code.
- o The standards-setting process in the U.S. is open to participation by foreign suppliers. This practice is unique to the U.S. Restrictive practices in Italy effectively deny foreign suppliers national treatment.
- o The USG and Japan recognize foreign-generated test data, permit manufacturers' self-certification and allow minor changes in FCC-registered equipment without requiring re-certification. It should be noted, however, that most developed countries have restrictive policies in these areas, and that Italy's policies are not in violation of its GATT Standards Code commitments.

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- o Criteria for equipment attachment are limited to "no-harm-to-the-network" in the U.S. and Japan. Few other countries follow this practice, however, and stricter Italian standards are not a violation of the Standards Code.

Network Equipment

- o USG telecommunications procurement entities practice open international competitive bidding for network equipment. The U.S. is unique in this respect. The GOI allocates the market for network equipment which effectively denies national treatment to foreign suppliers. The Italian PTT is not, however, obligated by the GATT Government Procurement Code.
- o Unlike the civilian USG specifications development process, the Italian process does not allow foreign suppliers the same access as domestic suppliers. Foreign suppliers are therefore denied national treatment. It should be noted, however, that most countries do not permit foreign suppliers access to specifications development processes.

Value Added Services

- o There are no restrictions on the offering of valued-added services by private companies on the public switched network in the U.S.
- o There are no restrictions on third party use of leased lines connected to the public switched network in the United States, the U.K. and Japan. However, many developed countries continue to restrict third party access to leased lines.

The FCN Treaty between Italy and the U.S., signed in 1948, provides for national and MFN treatment to nationals, corporations and associations of the other party with respect to engaging in commercial activities within its territory. It provides for fair and equitable treatment with respect to purchases and sales by certain state enterprises, and provides a modified form of MFN treatment with respect to government purchases and contracts.

Monopolies or agencies granted exclusive privileges to provide services are required to provide fair and equitable treatment with respect to transactions involving such services. The exception is made for postal services, but telecommunications is not specifically mentioned.

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The FCN also calls upon each party, upon request, to take such measures as it deems appropriate to eliminate any harmful effects on bilateral commerce caused by anticompetitive practices, including practices which limit market access or foster monopolistic control.

The FCN clearly requires MFN treatment of imported goods, unless other treatment is permitted by the GATT. Therefore, any retaliatory action under Section 301 would be inconsistent with the FCN unless it were first sanctioned by the GATT.

C. Effect on Competition

The size of the Italian market for telecommunications equipment was estimated at \$2.933 billion for 1986, and is expected to grow at a rate of 16.4% through 1989. Terminal equipment accounts for \$293 million (10%) of this and network equipment accounts for \$1.994 billion (68)%. Total imports in 1986 were estimated at \$442 million, and are expected to be approximately \$673 million by 1989. Imports of U.S. manufactured equipment in 1986 totaled \$35.9 million, or about 1.2% of the total market.

In 1984 the U.S. enjoyed a \$28.1 million surplus in telecommunications trade with Italy. In 1985 the surplus was halved to \$14.5 million. U.S exports to Italy declined from \$36.1 million in 1985 to \$35.9 million in 1986.

It is not possible to estimate the amount of U.S. sales lost as a result of these barriers. Limited experience with the more open markets of Japan and the U.K., and the lack of access to other major markets, preclude comparative market-share analysis. These practices affect the ability of U.S. suppliers to compete in the Italian telecommunications market and could therefore be considered a burden on U.S. commerce.

D. Status of Consultations

Market Access Fact-Finding talks were held with the Italians in April and December of 1986. A letter from Secretary Baldrige to PTT Minister Antonio Gava summarizing U.S. concerns was sent in March. Minister Gava's reply to this letter emphasized limited steps toward liberalization of certain parts of the terminal equipment market but showed little indication of further changes. The Italians have expressed an interest in further discussions with the U.S. on market access issues.

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Legislation to liberalize maintenance of terminal equipment was passed in March of 1987. Legislation to liberalize private networks and legislation calling for the reorganization of the GOI telecommunications sector have not yet been reintroduced in the new legislature. Prospects for the reorganization bill appear dim due to resistance from unions and other political forces.

II. Advantages and Disadvantages of Self-Initiation

A. Advantages

1. Could cause the GOI to reintroduce legislation aimed at liberalizing the telecommunications sector.
2. 301 action against Italy could have a positive effect in opening other markets.

B. Disadvantages

1. Italy would not be a good test case for 301 action because the Italian telecommunications market is not as large as that of other European countries, and Italy is not as influential in European telecommunications policy-making. Moreover, Italy may protest that its policies are not as unreasonable as other developed countries' policies.
2. 301 action could be counterproductive, unlike less confrontational initiatives, causing liberalizing elements within the Italian Government to reject "external demands."
3. 301 action at this time could impede progress, i.e. it could send the wrong signal following the passage of modest liberalization legislation in March, 1987, and could negatively influence potential legislation aimed at further liberalization.
4. Confrontation over Italy could negatively affect progress towards liberalization in other European countries as well.
5. Would move the locus of the issue to the EC Commission which is less likely to obtain short term results, and could lead to rounds of retaliation and counterretaliation on other sensitive products.

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6. Is unlikely to result in more open Italian telecommunications market. Given the small amount of Italian telecommunications exports to the U.S. and the current U.S. trade surplus in telecommunications with Italy, we have little leverage in this sector.
7. Many of the recent Section 301 disputes with the EC (i.e., canned fruit, citrus and pasta) have involved Italian trade interests disproportionately. Italy would view a Section 301 case on Italian telecommunications policies as an indication that the U.S. is singling out Italy in its trade disputes with the EC, and the GOI would be likely to respond in an antagonistic manner.

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SECTION 301 ANALYSIS
TELECOMMUNICATIONS BARRIERS IN JAPAN

Prior to 1981, Japan's telecommunications market was virtually closed to foreign participation. Since that time, it has undergone a substantial transformation, and is now, in a regulatory sense, one of the most open in the world. Starting with the bilateral agreement to open up NTT procurement (which took effect in 1981), Japan has taken extensive measures to revise its regulatory framework for telecommunications equipment and services. The MOSS talks, which were held in 1985-1986, affected all major aspects of Japan's regulation of wired and wireless equipment and services.

The result of the MOSS talks was to revise most regulations that negatively affected the ability of foreign firms to compete fairly in Japan's telecommunications market. Although some problems have appeared in the implementation of these measures, most have been resolved satisfactorily, and virtual parity has been achieved with U.S. procedures. Currently, there are only two areas that can be categorized as significant barriers for the purposes of this paper. These include foreign participation in groups offering international telecommunications services in competition with KDD, and Japanese government policy concerning its procurement of foreign communications satellites. Because these two problems are unrelated and very specific, we are analysing them separately.

FCN Treaty

The U.S.-Japan Treaty of Friendship, Commerce and Navigation, signed in 1953, provides national treatment to nationals and companies of one party engaging in commercial activities within the territory of the other party. However, there is a specific exception for public utilities, which are understood in the Protocol to include enterprises which provide communications services. The FCN treaty also requires state enterprises to make procurement decisions on solely commercial considerations, and provides modified MFN treatment with respect to government or state enterprise procurement (although there is a limited exception to the latter provision for PTTs).

The FCN Treaty provides MFN treatment with respect to goods, with the exception of actions specifically permitted by the GATT. Therefore, any retaliation taken against Japan as a result of a Section 301 proceeding which is not sanctioned by the GATT would violate the FCN Treaty.

SECOND KDD

I. Technical Criteria

A. Trade and Investment Barrier

Japan's Telecommunications Business Law, which was revised extensively in 1985, allows for new Type I companies (common carriers) to enter into competition with KDD, a monopoly company that serves as Japan's international telecommunications carrier.

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The law specifies that foreign firms may have up to one-third ownership in any Type I group approved to offer international services.

Following passage of this law, two consortia formed in hopes of winning approval from Japan's Ministry of Posts and Telecommunications (MPT) to compete with KDD. One group, called ITJ, consists entirely of Japanese companies (Mitsubishi, Mitsui, Sumitomo, etc.). The other group, called IDC, includes one third foreign equity (Pacific Telesis, Cable and Wireless of Britain, and Merrill Lynch).

MPT originally indicated that it felt that there was room for only one competitor to KDD, and urged the two groups to merge. Prolonged merger talks between the groups got bogged down over such questions as the extent of foreign participation in core management of a merged group. The key sticking point was whether or not the merged group would build a new trans-Pacific cable or simply use existing KDD transmission facilities. IDC favored a separate cable, while ITJ opposed it. The merger talks broke down on August 4 due to disagreement over this issue.

Each consortium is now expected to submit separate applications to MPT for approval. Although MPT's official position is that it will review both applications fairly based on the Telecommunications Business Law, it has indicated informally in the past that if the merger talks broke down, it would have to study IDC's application; indications are that this could take up to 3 months. The ostensible purpose for studying the IDC application is to determine whether sufficient demand exists to support IDC's request for a separate trans-Pacific cable. However, IDC has already conducted a feasibility study supporting construction of a separate cable. KDD's recent interest in expanding its capacity also indicates recognition of sufficient demand.

B. Basis for Determining Barrier Unreasonable

If MPT approves both groups' applications expeditiously, no problem will exist and free and fair competition will have been fostered. If, however, it either disapproves IDC's application or delays approval so long as to put it at a significant competitive disadvantage, it could be argued that it is denying IDC's U.S. members national treatment and fair and equitable market access, and this action could be considered unreasonable under section 301. It would also violate the spirit of the revised Telecommunications Business Law and send a signal to other foreign firms wishing to compete in Japan's telecommunications services market that MPT will determine the degree of competition allowed. It should be noted that trade in services is not currently covered by the GATT.

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C. Effect on Competition

KDD's estimated revenues for international services are \$1 billion per year. It is not possible to estimate the damage that would result to U.S. industry if the IDC application is not approved, or if it is delayed significantly. The financial projections of the affected U.S. firms are not available to us. U.S. firms would hold about 13 percent equity in IDC.

D. Status of Consultations

This issue has been raised with Japanese officials numerous times. Letters have been sent from the President, former Secretary Baldrige, and other high level officials. It has been discussed in numerous meetings with MPT and other officials, and will be raised at the upcoming U.S.-Japan Trade Committee meeting at the end of August. We will continue this approach until the issue is resolved.

II. Advantages and Disadvantages of Self-InitiationA. Advantages

1. Demonstrates U.S. resolve in fighting Japanese backsliding in implementing past measures.
2. Might stimulate approval of IDC's application.

B. Disadvantages

1. Japan has not yet made a decision against U.S. suppliers in this case.
2. Japan's law does not guarantee any foreign participation in this type of business.
3. Might jeopardize numerous gains achieved in MOSS.
4. President and Prime Minister have exchanged letters on this subject, and consultations at other levels are continuing. 301 case prior to conclusion of these would be premature.

SATELLITESI. Technical CriteriaA. Trade and Investment Barrier

In 1983, Japan's "Long-range Vision on Space Development" articulated a policy of autonomously developing a satellite and associated launch service industry. The policy included a prohibition against procuring foreign satellites.

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In response to U.S. concerns, Japan has clarified this policy. Private Japanese companies may buy imported telecommunications satellites but government entities may not if such a purchase interferes with indigenous development objectives. Three joint ventures have been established to sell or lease U.S.-made telecommunications satellites to private entities.

B. Basis for Determining Barrier Unreasonable

Because Japanese policy requires that satellite procurement by public organizations including NTT must be "consistent with the national development policy," NTT is effectively precluded from buying foreign satellites, probably through 1992. Although U.S. firms have supplied many of the components going into Japan's telecommunications, broadcast, and weather satellites, they would prefer to sell complete satellite systems.

Japan's policy is more restrictive than that of the U.S., as most U.S. Government agencies that procure satellites use open international bidding procedures consistent with the Government Procurement Code. Japan's National Space Development Agency (NSDA) the only other major Japanese public entity which procures satellites, does not follow these guidelines. NTT and NSDA are not Code-covered entities. Japanese satellite procurement policies deny U.S. firms national treatment and fair and equitable market access, and could be considered unreasonable under Section 301. It should be noted, however, that the National Space Development Agency is not covered by the Government Procurement Code.

C. Effect on Competition

U.S. satellite manufacturers are world leaders in terms of quality and advanced technology. If allowed to compete in this market, U.S. firms should receive a significant share of an expanding market. The Government of Japan accounts for less than half of the \$1 billion plus Japanese communications satellite market. Japan's policy provides a protected home market as a springboard to effective competition with U.S. firms both in the U.S. and third countries.

D. Status of Consultations

In MOSS Electronics negotiations and other discussions, the United States has repeated its serious concern about this Japanese policy. The United States has sought assurances that U.S. companies will be allowed to compete in Japan's government satellite market. Thus far Japan has refused to let its government entities buy U.S.-built satellites. In light of Japan's adamant position, the U.S. has not raised this issue recently.

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II. Advantages and Disadvantages of Self-initiation

A. Advantages

1. Would signal U.S. resolve to act against explicit Japanese policy prohibiting foreign satellite purchases by government entities.
2. Would penalize Japan for policy designed to protect its developing indigenous satellite industry.

B. Disadvantages

1. May not be supported by U.S. industry, which is more interested in selling to larger Japanese private sector.
2. Might endanger gains achieved in MOSS.
3. U.S. has not raised this issue with Japan recently. Initiating 301 without prior consultations may be considered by the Japanese to be unfair treatment.

**Trade and Investment Barriers
in the Korean Telecommunications Market**

Although the Koreans have begun to liberalize their telecommunications policy, significant barriers still remain to U.S.-Korean telecommunications trade. The most significant of these are: restrictions on foreign equity investment in VAS ventures; limited implementation of the type approval process for telecommunications equipment; and high tariffs on telecommunications equipment.

Korea is launching an effort to gain market share in the U.S. and in developing country markets. Within the U.S. domestic market, the Koreans already have widely established distribution channels for their consumer electronic and computer products. These will facilitate the export of PBX's, keyphones, carrier transmission and other equipment to the U.S. market. The Koreans are also expanding their sales efforts to the network equipment markets of the developing countries.

I. Technical Criteria

A. Significant Barriers to Trade and Investment

1. Terminal Equipment:

- a. Terminal equipment is, in most cases, subject to lot-approval rather than type-approval.
- b. Manufacturers are not allowed direct access to the standards setting process. Trade associations are allowed to participate in the formulation of standards, but their input is seen as ineffective.
- c. Foreign and manufacturer-generated test data is not accepted by the ROKG in its approvals process. Only test data from official ROKG test centers is accepted during the approvals process; other test data can be submitted as supporting data only.
- d. Self-certification is not allowed in Korea.
- e. The first telephone set must be provided by the Korean Telecommunications Authority.
- f. Tariffs remain high on terminal equipment, within the 15% range.

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2. Network Equipment

- a. Foreign suppliers for any public sector procurement in Korea are encouraged to submit "voluntary" local content proposals as part of the bid. The ROKG will reportedly not consider bids unless a local content proposal is included.
- b. U.S. companies seeking to set up manufacturing operations in high-tech areas, such as fiber optics, digital switching systems, cellular communications equipment, etc., are restricted to joint ventures with existing Korean firms. The establishment of joint ventures is often dependent on the transfer of technology to the Korean party.
- c. Although many tariffs on telecommunications equipment were lowered in July, 1987, tariffs for public exchange digital switching equipment are slated to increase from 10 percent in 1987 to 15 percent in 1988.

3. Services

- a. The provision of value-added services is restricted to companies which have at least 50 percent ownership and where the local investor maintains management control.
- b. Competition in value-added services is restricted to intra-corporate value-added networks. The only services exempted from this restriction are "data communications services," i.e., data management, computer hardware and software services.
- c. The ROKG prohibits the resale and/or shared use of leased lines outside of the intra-corporate networks.

B. Basis Upon Which Barriers Considered Unreasonable

We recognize that Korea is a newly industrialized country and that international trends towards the liberalization of telecommunications are being led by the major industrial nations. However, Korea's goal to be a net exporter of data by the year 2000, combined with its advanced telecommunications infrastructure, require that the USG judge Korea by the same standards as the more industrialized nations. Therefore, we are

comparing Korea to standards found in both the United States and other major industrial nations.

The following discusses whether the practices could be considered unreasonable under the legal requirements of Section 301, in that they deny national treatment and/or fair and equitable market access to U.S. firms.

1. Terminal Equipment:

- a. The use of lot approval by the ROKG could be unreasonable as it denies U.S. firms fair and equitable market access. Terminal equipment is subject to the type-approval process in the U.S. and the U.K. Use of type approval for terminal equipment varies within the European countries; however, the European Commission has proposed adoption of a comprehensive and expedited type-approval process by 1992.
- b. Limited access to the Korean standards setting process denies national treatment and fair and equitable market access to U.S. firms. Participation in the Korean standards-setting process is restricted to Korean trade associations (which can include foreign member companies). Therefore, this practice could be considered unreasonable because both domestic and foreign manufacturers openly participate in the U.S. standards setting process. While the transparency of the standards setting process varies by country, the U.S. is the only one that has an entirely open standards development process. Korea's standard setting procedures, however, do not seem to violate its GATT Standards Code commitments.
- c. Foreign and manufacturer-generated test data are not accepted by the ROKG in its approvals process, as such data are in the U.S. Only test data from official ROKG test centers are accepted during the approvals process; other test data can be submitted as supporting data only. Therefore, ROKG testing requirements may deny U.S. firms fair and equitable market access and could be considered unreasonable. While acceptance of foreign and manufacturer-generated test data is rare today, the U.S. and Japan do allow such data in their

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approvals process.

- d. Self-certification is not allowed in Korea. The U.S. allows manufacturers to register their products with the FCC based on manufacturer-generated test data, as does Japan. Although most other countries do not allow self-certification, Korean practices may deny fair and equitable market access to U.S. firms and could therefore be considered unreasonable.
- e. The first telephone set must be provided by the Korean Telecommunications Authority; the U.S., U.K., and Japan allow customer choice of all terminal equipment. Although support for customer choice among EC members is unclear, the EC has proposed customer choice including the first telephone set as a long-term objective. Therefore, Korean attachment policies deny fair and equitable market access and could be considered unreasonable.
- f. Tariffs remain high on terminal equipment, within the 15% range; this contrasts with international trends towards lower tariff rates in other developed countries. Therefore, Korean tariff practices may deny fair and equitable market access to foreign firms, and could be considered unreasonable. However, Korean tariff practices do not seem to be in violation of its GATT commitments.

2. Network Equipment

- a. Foreign suppliers for any public sector procurement in Korea are encouraged to submit "voluntary" local content proposals as part of the bid. The ROKG will reportedly not consider bids unless a local content proposal is included. This practice is not in evidence in any of the major telecommunications markets; it thus denies national treatment to U.S. firms and fair and equitable market access to foreign firms and could be considered unreasonable. Korea, however, is not a Signatory to the GATT Government Procurement Code, so this practice does not seem to violate its GATT commitments.

- b. Korean joint venture restrictions in high-tech areas, along with technology transfer requirements, creates hurdles to U.S. investors which Korean investors do not face in the U.S. market. These restrictions deny U.S. firms national treatment and/or fair and equitable market access, and therefore could be considered unreasonable.
- c. The raising of tariffs on public exchange digital switching equipment is contrary to international trends towards lower tariff rates in other developed countries. Therefore, Korean tariff practices deny fair and equitable market access to foreign firms, and could be considered unreasonable. However, Korean tariff practices do not seem to violate its GATT commitments.

3. Services

- a. Korean investment restrictions on the provision of value-added services are in contrast to the more open policies of the U.S., the U.K., and Japan. The degree of investment restrictions on provision of value-added services varies among the European countries; the EC, however, proposes lifting such restrictions. These Korean restrictions deny national treatment and fair and equitable market access to U.S. firms and could be considered unreasonable. Trade in services is not currently covered under the GATT.
- b. ROKG restricts the provision of value-added services to intra-corporate value-added networks, whereas, the U.S., the U.K., and Japan allow greater competition in this area. While some restrictions remain in several European countries, the EC has proposed that the provision of value-added services should be unrestricted. These Korean restrictions deny fair and equitable market access to U.S. firms and thus could be considered unreasonable. Korean restrictions on services, however, do not seem to violate its GATT commitments.
- c. The ROKG prohibits the resale and/or shared use of leased lines outside of the intra-corporate networks. There are no

restrictions on third-party use of leased lines connected to the public-switched network in the United States. While other countries still maintain restrictions on third-party use, there is a growing trend among countries to reduce such restrictions, including Japan and the U.K. Korean restrictions, therefore, may deny fair and equitable market access to U.S. firms and thus could be considered unreasonable. However, Korean regulations governing the resale and/or shared use of leased lines do not seem to violate its GATT commitments.

4. U.S.-Korea Treaty of Friendship, Commerce, and Navigation (FCN)

The FCN signed in 1956 between Korea and the United States guarantees national treatment to U.S. firms in Korea, but specifically exempts the area of "communications" from this guarantee. The FCN may require each party's state enterprises to make procurement decisions solely on commercial considerations, which would make reported Korean telecommunications procurement practices inconsistent with the FCN. However, this provision could be interpreted to provide only MFN rather than national treatment, as has Article XVII of the GATT, on which it is based.

The FCN does clearly require MFN treatment of imported goods, unless other treatment is permitted by the GATT. Therefore, any retaliatory action under Section 301 would be inconsistent with the FCN unless it were first sanctioned by the GATT.

C. Effect of Barriers on Competition

The size of the Korean market for telecommunications equipment was estimated at \$3.7 billion in 1986. Customer premises equipment accounts for about \$1.4 billion of this amount and network equipment about \$1.5 billion. Figures are not available on the size of the market for value-added services. U.S. exports to Korea in 1986 totaled \$104 million, approximately 3 percent of the overall Korean market for telecommunications equipment.

It is not possible to estimate the amount of U.S. sales to Korea which have been lost due to localization of production through local content requirements,

foreign investment, technology transfer, and maintenance of tariff and non-tariff barriers. Korea's aggressive localization programs have led to a Korean telecommunications industry that has used its protected home market as a springboard to effective competition with U.S. firms both in the U.S. and third countries. Korea has already done this in the less advanced telecommunications technologies, i.e., telephone handsets, radio paging equipment, etc.

D. Status of Consultations

USG-ROKG telecommunications consultations began in January, 1987. As of July, 1987, USG officials had met with ROKG officials three times. These consultations have been successful in conveying USG concerns regarding the closed nature of the Korean telecommunications market. The ROKG has moved on a number of these concerns and has made positive steps towards opening its market.

The tangible results of these consultations can be seen in the expanded use of type-approval by the ROKG, tariff reductions on telecommunications equipment, and the decision to allow intra-corporate value-added networks. Ministry of Communications officials have stated that they intend to further liberalize the value-added services market and allow the interconnection of intra-corporate value-added networks to the public-switched network. They have also asserted that they will further expand the use of the type-approval process to cover keyphones, and almost every kind of modem at a variety of speeds. In addition, the Koreans have shown interest in U.S. procedures for accepting foreign test data.

The USG has offered to host the next round of discussions in September. No definite plans have been announced at this writing.

II. Advantages and Disadvantages of Self-Initiation

A. Advantages

1. Recent Section 301 actions undertaken against Korea have largely resulted in successful resolution of the issues.
2. Very little progress has been made on some key market access issues (e.g., agriculture,

cigarettes) which have not been the subject of 301 actions.

3. Taking a 301 action would serve as an example to both NICs and developing countries that they cannot both protect their home market and expect to export fully to foreign markets.

B. Disadvantages

1. A self-initiated Section 301 against Korea would be premature, as the issue has not been sufficiently discussed in bilateral consultations.
2. The Koreans have announced their intentions to liberalize the telecommunications sector. Since May, they have announced several steps to liberalize policies concerning type approvals and VAS provision. Taking a 301 action now could reverse recent progress already achieved.
3. Korea is undergoing major, rapid political transformation at this time. A self-initiated Section 301 action against Korea would politicize the issue at a time when Korean Government flexibility to respond would be limited due to the domestic political situation.
4. Several agencies would argue that other issues, e.g., agriculture, would stand in line before telecommunications for consideration of a 301 action. The USG has communicated the priority of other issues to the ROKG; to place telecommunications before those issues already targeted for 301 actions would undermine USG credibility.

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THE NETHERLANDS

I. Technical Criteria

In 1986, the Dutch Parliament approved a plan to liberalize telecommunications in the Netherlands. A bill encompassing this plan is under consideration and is expected to be presented to the Parliament by the end of this year. According to this plan, the legislation will transform the PTT from a government department to a public corporation on January 1, 1989. Moreover, regulatory functions will be transferred from the PTT to the Ministry of Transport and Public Works. Under this new regime, draft regulations will be published, and there will be an opportunity to comment for both domestic and foreign firms.

A. Significant Barriers to Trade

1. Terminal Equipment

The Dutch PTT, which is a government administration under the Department of Transport and Public Works, has traditionally had a monopoly over the provision of telephone and telex equipment and services in the Netherlands. At present, subscribers to the public telephone network may use only terminal equipment, such as key systems and Private Branch Exchanges (PBXs) that are supplied by the PTT. The PTT develops standards for and certifies terminal equipment and presently uses a standard that exceeds the U.S. "no harm to the network" standard. Moreover, the Dutch PTT does not currently provide for self-certification based on test data from U.S. or U.S.-owned laboratories. We anticipate, however, that once the draft legislation has been passed, the only remaining barrier will be the non-acceptance of U.S. test data.

2. Network Equipment

At present, the Dutch PTT often uses selective bidding procedures, accounting for approximately eighty percent of total consumption. Generally, the Dutch PTT limits its procurement of network equipment to firms that have manufacturing facilities in the Netherlands. The Dutch PTT has completed its digital switch purchasing plans through 1989. The firms chosen to supply the initial procurement include the joint venture between AT&T and Phillips (APT), Ericsson, and ITT, with APT awarded the largest -- that is, sixty percent -- share. Moreover, the U.S. has a favorable telecommunications trade balance of nearly \$70 million with the Netherlands. Indeed, U.S. exports of telecommunications equipment to the Netherlands increased by 443% since 1981 (from a base of \$19 million) -- a much larger increase than U.S. telecommunications exports to the rest of the world.

Classified by: S. Bruce
Wilson
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3. Services

The Dutch PTT has a monopoly over the provision of what are considered "basic" services in the United States. The Dutch railroad and electric utilities are permitted, however, to maintain their own private networks, although these networks may not interconnect with the PTT's telephone network. Under the draft legislation that is to be submitted to the Parliament, there will be a distinction made in the Netherlands between "concessionary" services -- that is, services the PTT will retain a monopoly over and will be obligated to provide -- and non-concessionary services -- that is, services that will be open to competition.

The PTT's concession will be confined to telephone, telex and telegraph, and data transport. Functions that involve merely routing and charging calls will be considered basic, while additional functions, such as protocol conversion and store and forward will be considered as enhancements that can be provided on a competitive basis. In addition, the PTT will not have an exclusive concession for cable television -- a service that presently reaches close to seventy percent of the homes in the Netherlands with television. Finally, while the PTT will be permitted to provide non-concessionary services, it will be required to separate the two organizations that provide concessionary and non-concessionary services over a five year period.

B. The basis on which we consider these barriers unreasonable

It is difficult to determine at this point which, if any, barriers to trade and investment that may remain after the adoption of the proposed Dutch law the U.S. government would find unreasonable. At this point, it would be fair to suggest that we may well have fewer market access concerns with regard to the Dutch telecommunications market than any other market in continental Europe. Simply put, the concerns that have been raised by U.S. firms focus on two areas: (1) terminal equipment and (2) value added services. In both of these areas, the proposed Dutch legal regime appears to be more liberal than most, if not all, other continental European countries.

Dutch PTT officials have stated that the proposed legislation would provide for changes in standards, certification procedures, transparency of process, and procurement. Specifically, the Dutch have said they plan to implement a "no harm to the network" standard comparable to the approach used by the U.K. and Sweden, although the standard may include a minimum performance requirement. In addition, Dutch officials observed that the legislation would provide for self-certification and acceptance of data from accredited labs from other EC countries. Under this approach, proposed Dutch terminal equipment standards will be published in the GON State Gazette, with a two month comment period, and the GON will notify the GATT Standards Code of new specifications. Finally, Dutch government officials

stated that they support an EC recommendation to open procurement for terminal equipment by 1992.

Therefore, post-legislation, the only remaining barrier in the area of terminal equipment will be non-acceptance of U.S. test data. This is not a violation of the GATT or GATT Code. As with the U.K., it would be difficult to characterize this action as "unreasonable" within the terms of Section 301. No European country currently accepts U.S. test data. Moreover, in light of the 443% increase in U.S. exports of telecommunications equipment into the Netherlands since 1981, it would be hard to argue that U.S. commerce has been burdened or restricted. Thus, it would be very difficult to make a convincing argument that practices regarding terminal equipment are unreasonable. Similarly, the approach planned for the provision of value added services in the Netherlands appears to address the primary market access concerns the U.S. has voiced in discussions with other countries. Therefore, again it would be very difficult to characterize proposed Dutch treatment of value added services as unreasonable.

C. Status of Consultations

There have been two FCC-led interagency discussions with Dutch government officials this year. The first set of discussions, which took place in Washington in February, focused primarily on the U.S. experience and the possible lessons that Dutch officials may be able to glean from the U.S. experience. The second set of discussions, which took place in the Hague in June, focused on the proposed Dutch legislation and Dutch plans for liberalization. Dutch government officials promised the U.S. delegation that we would be provided with copies of the draft legislation that is provided to the Parliament later this year and that it would be considered entirely appropriate for the U.S. government to provide input on the draft legislation at that time.

II. Advantages and Disadvantages of Self-Initiation

A. Advantages

1. A 301 action might encourage greater liberalization in network procurement.

B. Disadvantages

1. Upon adoption of its proposed legislation, the Netherlands will have among the most, if not the most, liberal telecommunications policy on the continent.
2. The restructuring of the PTT is an historic change and privatization remains a possibility for the future.

3. The prospect of significant liberalization in the Netherlands has served, and will continue to serve, as an example and a potential competitive threat to other continental European countries.

4. A 301 action might freeze or delay the process of liberalization in the Netherlands.

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SECTION 301 ANALYSIS

SPAIN

(NOTE: The Spanish Government is in the final stages of considering a draft Law on Telecommunications that would establish -- for the first time -- a formal policy on telecommunications. Approval is expected this fall. Formulation of the implementing regulations has already begun.)

I. Technical CriteriaA. Significant Barriers to Trade and Investment1. Terminal Equipmenta. Procurement

The Spanish PTT, Compania Telefonica Nacional de Espana (CTNE), has exclusive control over the connection of terminal equipment to the public network. During technical discussions between U.S. and GOS representatives in April 1986, Government officials expressed optimism that customer premises equipment (CPE) would be liberalized in the future.

The draft Law on Telecommunications (LOT) notes that the implementing regulations will determine the rate of "free acquisition" of terminal equipment. On the other hand, the LOT states that "certain types of terminals may be maintained" under a monopoly (CTNE).

b. Testing and Certification/Standards

CTNE maintains burdensome telecommunications standards and time-consuming certification processes for CPE. In mid-1986, the Ministry of Industry announced new industrial standards for telephone terminals, automatic dialers, answering machines, and modems. Under this Royal Decree, telephone terminals and transmission modems must be adjusted to the standards of the Ministry of Transport, Tourism and Communications. Homologation costs will almost certainly be increased for small and medium-sized exporters of this equipment to Spain.

Importers previously had problems with identifying the appropriate laboratories for certification. Often labs had not been established for this purpose. Earlier this year, the Directorate General

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for Telecommunications (DGT) announced it was setting up its own laboratories to analyze equipment proposed for interconnection to the system.

2. Network Equipment

a. Procurement

CTNE accounts for two-thirds of all telecommunications purchases in Spain. The PTT buys over 75 percent of its equipment from Spanish companies, many of them CTNE subsidiaries. The GOS intends to increase this share to 80 percent in 1989.

ITT (through Standard Electrica) and Ericsson supply the central office switching equipment. In a meeting with Assistant Secretary Sikes last December, CTNE President Solana indicated that his company was looking for a third supplier but predicted that a final decision on this would not come soon.

CTNE is actively seeking out foreign companies to establish joint ventures in advanced technologies. So far, the company has interests in such ventures with AT&T, Corning, Pacific Telesis, as well as European and Japanese companies. AT&T and CTNE are negotiating a joint venture to produce network plant gear including connectors, distribution boxes, and other equipment. The AT&T/Philips venture (APT) has taken over Marconi and may use the company to produce switching equipment.

3. Services

a. Competition

CTNE has an effective monopoly over all public telecommunications services. Certain public utilities operate their own distribution systems. The only open competition is in radio paging.

The LOT will determine the future prospects for value added services offerings by foreign companies. The Law appears to reserve some enhanced services for the monopoly (CTNE) and creates the possibility of eventually re-regulating those services initially opened to competition.

The LOT also limits foreign ownership in telecommunications services to 25 percent. U.S. companies believe the LOT provisions on services would be a major investment disincentive.

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B. Criteria for "Unreasonable" Barriers

Many of the policies and practices of the Spanish Government run counter to international practices and trends as evidenced by regulations in the U.S., Japan, Canada and the United Kingdom, as well as the proposals of the EC Commission. The following discusses whether the Spanish practices -- both current and prospective -- could be considered unreasonable within the meaning of Section 301, in that they deny national treatment and/or fair and equitable market access to U.S. firms.

1. Terminal Equipment

o Procurement

Both Japan and the U.S. allow for free competition in terminal equipment. The European Commission recently called for the phased opening of the terminal market. Spain's liberalization in this sector has been limited and could be viewed as unreasonable in denying free and equitable market access.

The extent and timing of further liberalization of terminal equipment in Spain will be determined by the LOT and its implementing regulations. The final version of the LOT and these regulations will determine if Spanish liberalization policy in this area is unreasonable in the context mentioned above. It should be noted that most countries do not allow self-certification or accept foreign manufacturer-generated test data.

o Testing and Certification

Self-certification is not allowed in Spain, but is allowed in the United States and Japan. Foreign and manufacturer-generated test data is not accepted by CTNE in its approval process. The United States and Japan accept foreign-generated test data. Given these current trends in easing testing and certification standards, Spanish policy could be construed as unreasonable in that it does not provide fair and equitable access to its telecommunications market.

2. Network Equipment

o Procurement

USG telecommunications procurement entities practice open international competition bidding for network equipment. To date, Spain has limited procurement of network equipment to select suppliers, many of which are CTNE

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subsidiaries. Thus, CTNE's procurement policy could be viewed as unreasonable in its denial of national treatment and fair and equitable market access. However, the United States is the only developed country to have fair and open procurement procedures for network equipment. Further, CTNE is exempt from Procurement Code obligations. CTNE also has shown some inclination toward working with U.S. firms on joint ventures. These ventures could result in major business opportunities in the future.

3. Services

o Competition

The United States and several other countries do not restrict the offering of value-added services by private companies on the public switched network. The EC Commission has called for substantial opening of the services market to open competition, restricting telecommunications administrations to voice telephony only. In contrast, CTNE is the sole provider of telecommunications services in Spain. If enacted, the LOT would appear to maintain CTNE's predominant role in this area and thus would deny U.S. firms fair and equitable access to the Spanish market.

- o The LOT's restrictions on foreign ownership of value-added services represents a major investment disincentive for U.S. companies. The U.S. does not have similar restrictions in this area. Spanish policy in this area, if retained in the LOT, could be viewed as unreasonable in denying national treatment to U.S. firms.

4. FCN Treaty

A cursory reading of the Treaty of Friendship and General Relations between the United States and Spain (signed in 1903) seems to indicate that the pact has little or no bearing on this issue.

C. Effect of Barriers

1. Overseas

The effect of Spain's telecommunications trade barriers on U.S. trade is difficult to determine. Although CTNE subsidiaries have been active in Latin America and other areas in supplying rural telephone systems, switching networks and telephone sets, Spain's protected domestic market does not appear to provide Spanish suppliers with a competitive advantage in third country markets. This assessment is based on the fact that Spain has not yet

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developed large quantities of advanced telecommunications equipment and that U.S. products are comparable or superior to Spanish technology.

2. U.S. Market

Imports of Spanish telecommunications products play no significant role in the U.S. market. No industry allegations or complaints regarding Spanish subsidies and/or dumping have been received.

3. Damage to U.S. Industry

It is difficult to quantify any loss in sales as a result of Spanish trade barriers in telecommunications. However, according to the latest National Trade Estimate report, major liberalization of Spanish telecommunications policies could significantly affect U.S. sales by opening an additional market of \$50-75 million annually.

U.S. exports of telecommunications equipment amounted to \$21.3 million in 1986, down from \$30.8 million in 1985. The United States maintains a surplus in telecommunications trade with Spain (\$7 million in 1986), although it has diminished in recent years. Liberalization would probably have greater impact in CPE than in network equipment. Figures are not available on the size of the market for value-added services.

D. Status of Consultations

U.S. technical experts met with Spanish Government and industry representatives in April 1986. The talks centered on the LOT and the U.S. experience with deregulation. The GOS declined a second meeting this past spring but discussions are possible in October or November. If the LOT has been approved by that time, the talks will focus on the Law's implementing regulations.

II. Advantages and Disadvantages of "301" Self-Initiation

A. Advantage

1. Self-initiation could allow the U.S. to influence the outcome of the LOT so that the Law would take greater account of U.S. interests.

B. Disadvantages

1. Self-initiation could jeopardize passage of the LOT, which brings Telefonica under the control of the

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Ministry of Transport, Tourism and Communications. The success of subsequent USG-GOS negotiations will depend upon the Ministry's jurisdiction in this area.

2. Such action could be counterproductive to U.S. efforts to influence the substance and implementation of the LOT.
3. The Spanish telecommunications market is small relative to other markets being considered for "301" self-initiation.

Prepared by: JMcCarthy/ITA/TD/S&E/OT/x4466/8-31-87
HShaw/NTIA/OIA/x1803

File Name: "SPAIN"

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THE UNITED KINGDOM

I. Technical Criteria

The general telecommunications policy framework in the United Kingdom was established by the Telecommunications Act of 1984. Under its provisions, the Secretary of State for Trade and Industry was given the authority to grant licenses to provide telecommunications services and the Office of Telecommunications (OFTEL) was established to monitor compliance of licensees with license obligations, and arrangements were made to transfer British Telecom (BT) from public to private ownership. Therefore, a longterm U.S. objective with regard to fair treatment of U.S. telecommunications firms in foreign markets has been addressed in the U.K. -- that is, there is a separation of regulatory and operational responsibilities.

A. Significant Barriers to Trade and Investment

1. Terminal Equipment

Type approval procedures are now the responsibility of the British Approvals Board for Telecommunications (BABT), although the BABT is permitted to delegate its testing responsibilities to independent laboratories. Indeed, as of June 1987, for certain categories of equipment (telephones and modems), manufacturers have the option of choosing their own testing laboratories. Moreover, although there is not yet a full list of standards for terminal equipment, the British have essentially adopted a "no harm to the network" standard with associated safety requirements.

While it is not clear that there are any U.K. government policies that could be characterized as "barriers" to trade or investment with regard to the U.K. terminal equipment market, there are several very limited areas of concern. First, the relevant U.K. authorities do not accept test data from laboratories located in the United States. Second, the standard setting process is not yet transparent. The British Standards Institute (BSI) has the task of setting standards, and trade associations, unions, and the British government are permitted to participate in the process. Foreign manufacturers may participate in the BSI standard setting process, but only if they belong to a British trade association. Moreover, BSI has such a backlog that BT and OFTEL are setting some standards in the interim, until BSI catches up. BT's standards are proprietary, and outside participation is not permitted. OFTEL sets standards with help from selected participants.

2. Network Equipment

We have received no industry complaints of barriers in the U.K. for this sector.

Classified by: S. Bruce Wilson

Declassify on: OADR

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3. Services

Two public telecommunications entities have been licensed to provide basic domestic and international telecommunications service -- BT and Mercury -- with this duopoly policy scheduled for review in 1990. There is, however, a specialized satellite services exception to the duopoly policy that has not been addressed in a comprehensive fashion to date. Simple resale (that is, resale of basic services without any "enhancement") is prohibited before 1989; at that time the prohibition on simple resale will be reviewed. A new licensing regime has also been established to encourage the development of broadband cable systems. An operator wishing to provide entertainment and telecommunications services over a cable system requires two licenses, one from the newly established Cable Authority under the Cable Broadcasting Act of 1984 and the other from the Secretary of State for Trade and Industry under the Telecommunications Act of 1984. BT and Mercury's duopoly does not extend to broadband cable systems, but any cable operator wishing to provide voice telephone service must do so in collaboration with BT or Mercury, and the latter retain the right to interconnect systems and to provide data services in certain business centres.

The 1984 Telecommunications Act also requires so-called "private systems" to be licensed subject to certain, very limited exceptions. The Secretary of State for Trade and Industry has the power, however, to issue class licenses that cover private telecommunications systems. Earlier this year, the U.K. issued a class license for the operation of telecommunications systems providing value added and data services (VADS). This license permits the resale of leased capacity for telecommunications service except simple resale, basic voice or telex, land mobile radio, and cable TV. Providers of the so-called VAD services are subject to a registration requirement, a publication requirement, and certain other so-called "fair trading" conditions.

B. Basis on Which We Consider Barriers Unreasonable

At this point, the U.S. government has a limited number of points on which we would hope to make progress with the government of the U.K.. These include, among other things, the acceptance of U.S. test data for terminal equipment registered in the U.K., the extension of a more liberal regime for so-called VAD services to the provision of VAD services between the U.S. and the U.K., and the provision of separate satellite services between the U.S. and the U.K. Each of these questions involve difficult policy questions that require thorough and careful discussions. It would be difficult to characterize continuing U.K. restrictions in these areas, however, as "unreasonable" trade barriers.

None of the barriers listed above violate the GATT or the GATT Code. The non-acceptance of U.S. generated test data might be considered unnecessary if one decided that there was no technical reason to restrict

sources of test data. Only the U.S., Canada, and Japan accept test data from foreign sources. The non-acceptance of test data could be considered a burden on U.S. commerce, in that terminal equipment manufacturers must re-test in the U.K., with associated delays and costs. Since no other European country accepts foreign test data, and because of the tenuousness of the "unnecessary" categorization, it would be stretching a point to characterize the non-acceptance of U.S. test data as unreasonable.

The standards-setting process constitutes a de facto rather than a de jure barrier, and is by most accounts a temporary problem. In that some standards are set by BSI, through a transparent process, it would be very difficult to characterize this barrier as "unreasonable."

C. Effect of Barriers

The continuing restrictions discussed above may lessen competition in the provision of telecommunications and VAD services as well as the sale of telecommunications equipment in the U.K. It is not clear, however, to what extent such restrictions have an actual effect on competition in the U.K. or the U.S.

D. Status of Consultations

Several federal agencies, including the FCC, NTIA, and the Department of State, have had informal discussions with officials from the U.K. Department of Trade and Industry (DTI). Moreover, the FCC has established a continuing relationship with its sister regulatory body, the Office of Telecommunications. The FCC enjoys periodic visits from OFTEL on issues ranging from the regulatory treatment of terminal equipment to the application of international settlements policy. Moreover, FCC Chairman Patrick and OFTEL Director General Carsberg have met twice over the past several months to discuss issues of common interest and concern. Indeed, Professor Carsberg told Chairman Patrick in July 1987 that he is willing to consider the question of U.K. acceptance of test data from U.S. laboratories should any firm raise this question to OFTEL's attention.

DTI has not replied, however, to an invitation by former FCC Chairman Fowler to initiate formal bilateral discussions on terminal equipment, enhanced services and other issues. Moreover, a senior DTI staff official has informally expressed a reluctance to engage in any formal discussions, particularly any that would include representatives of U.S. trade agencies. This DTI official has suggested that he does not believe that there are any "trade" issues outstanding between the U.S. and the U.K. and that the U.K. is unwilling to permit the participation of officials of the EC in such discussions (which he believes would be required should U.S. trade officials be included on the U.S. side). Finally, this DTI official has suggested that the U.K. does not have sufficient staff resources to engage in formal bilateral discussions with the U.S. and would prefer to move forward on an ad hoc basis.

II. Advantages and Disadvantages of Self-Initiation

A. Advantages

1. Might lead to the acceptance by the U.K. of terminal equipment test data generated by U.S. laboratories.
2. Might accelerate the elimination of the prohibition on simple resale.

B. Disadvantages

1. The U.K. has moved further in the direction of liberalization in its domestic telecommunications regime than any other country in Western Europe. The British have given every indication that they will continue to move in the direction of liberalization, particularly in light of the recent Tory victory.

2. The U.K. has an independent regulatory authority, OFTEL, that provides a well-established legal forum for U.S. firms to address their concerns with the fair development of competition in the U.K. The initiation of a 301 action, absent full pursuit of U.S. complaints in that forum, might lead to countercharges that the U.S. has not "exhausted" existing U.K. domestic legal approaches -- that is, there would be a strong implicit criticism of their regulatory structure.

3. A 301 action could cause a withdrawal of goodwill that would jeopardize U.S.-U.K. relations in a variety of areas, particularly telecommunications, as well as ongoing negotiations in other sectors.

drafted by: R.Milkman/FCC/632-4047 rev. 8/24/87; rev. 8/31/87

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September 3, 1987

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: THE TRADE POLICY REVIEW GROUP

SUBJECT: JAPAN KANSAI AIRPORT CONSTRUCTION PRACTICES

Issue

The Economic Policy Council is to decide whether the Trade Representative will self-initiate a section 301 unfair trade investigation of Japanese Government practices in connection with the construction of the Kansai Airport.

Kansai Airport

The Airport Project: The Kansai International Airport Corporation (KIAC) is building an over \$7 billion airport near Osaka. KIAC is a "special" company established under the Kansai International Airport Corporation Law and controlled by the Ministry of Transportation. For example, the Ministry:

- o holds two thirds of KIAC shares;
- o authorizes any issuance of additional shares;
- o approves KIAC's yearly business plan and any subsequent changes to it, the appointment and dismissal of KIAC directors and auditors, and any changes in its articles of incorporation; and
- o in consultation with the Ministry of Finance, can veto KIAC's access to capital markets.

As a result, we consider KIAC an instrumentality of the Government of Japan.

Airport construction is scheduled to proceed in four phases: (1) building sea-walls, landfill and a bridge linking the airport island to the mainland, which has begun; (2) constructing the airport (runways and terminal building), expected to begin in 1990; (3) equipping the airport, scheduled to conclude by 1992; and (4) expanding the airport to include two more runways.

While sizable by itself, the Kansai Airport project is the first of several major such Japanese undertakings including the Trans-Tokyo Highway Bay Bridge and Narita Airport expansion projects.

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U.S. Meat Export Federation, National Pork Producers Council, American Farm Bureau Federation and National Cattlemen's Association. They charge that the directive denies national treatment (because its standards are not enforced in trade between EC member states, and do not apply within member states), and cannot be justified on the basis of scientific evidence. Because these issues arise under the GATT and Standards Code, we requested consultations under Article 23:1, which are scheduled this month.

However, we have no realistic hope of achieving an outcome under GATT dispute settlement procedures by January 1, when the temporary approvals of 59 U.S. plants expire. Unless they are certified, the result will be either a reduction in U.S. meat exports to the EC, or the incurrence of unnecessary expenditures by U.S. plants to conform to EC requirements.

EC Hormones. In January 1987, the U.S. asked for consultations under the Standards Code to complain of the EC's Animal Hormone Directive. This directive precludes the importation into the EC after January 1, 1988, of any meat produced from animals treated with hormones (which is widespread in the U.S.). We believe that hormones can be used safely under prescribed conditions, and that the EC should accept our residue testing program as a sufficient guarantee of the safety of meat from animals treated with hormones.

After the Standards Code Committee was unable to achieve a mutually satisfactory solution, in July 1987 the U.S. asked for the establishment of a technical experts group. The EC has blocked its establishment, interrupting the dispute settlement process. Unless the EC agrees soon to proceed, we may wish to consider self-initiating an investigation or acting under section 301. Even if the EC permits dispute settlement to proceed, however, it could not be completed prior to the implementation January 1 of the EC directive.

As a result of the Third Country Meat and Animal Hormone Directives, as of January 1, 1988, we expect U.S. exports of meat products to the EC to cease abruptly. The issue for the EPC will be whether and how to act unilaterally absent a satisfactory resolution in the interim. This issue must be addressed no later than early November, if public comment on proposed retaliatory measures were to be obtained and retaliation implemented by January 1.

Argentina Soybeans

The Government of Argentina has maintained higher export taxes on soybeans than on processed soybean products. This differential discourages the exportation of beans, puts downward pressure on the price of soybeans in Argentina, and thus provides a competitive advantage to the Argentine crushers of soybeans into soybean meal and oil.

In response to a petition filed by the National Soybean Processors Association in 1986, we initiated a section 301 investigation.

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Last May, the President suspended this investigation based upon the Argentine Government's commitment to eliminate or substantially reduce all export taxes by October 15.

On July 20 Argentina eliminated or significantly reduced the export taxes on all products except soybeans and sunflower seeds. It reduced the differential in taxes on soybeans and processed soybean products from 12 to 11 percent, which we do not consider a substantial reduction.

We are pressing the Argentine Government to fulfill its pledge by October 15. Argentina's Finance Minister will meet with Ambassador Yeutter at the end of September to discuss the problem. However, for Argentine domestic political and revenue reasons, we are skeptical how far the Government will move.

Agencies agree that this export tax differential distorts trade; despite repeated deliberations within the Section 301 Committee, they still disagree whether it is unjustifiable, unreasonable or discriminatory and a burden or restriction on U.S. commerce (the criteria of section 301). However, breach of Argentina's commitment to eliminate or substantially reduce all export taxes by October 15 would be independently actionable under section 301 as unjustifiable, if it also burdened or restricted U.S. commerce.

Absent a satisfactory settlement by October 15, the issue for the EPC will be whether and how to respond to Argentina's breach of its commitment and maintenance of an export tax differential that distorts trade. This issue would arise as of October 15, but there would be no need to act immediately to preserve the status quo (as in the EC meat matters).

Argentina Air Couriers

In 1984 the Air Courier Conference of America complained of the Argentine Government's restrictions on the delivery of time-sensitive commercial documents, which essentially prohibited U.S. couriers from the international carriage of such items. In November 1984 the President determined this practice to be unreasonable and a restriction on U.S. commerce. He directed the Trade Representative to consult further with Argentina, but to submit proposals for action under section 301 within 30 days if the issue were not resolved through consultations.

With the help of this leverage, we persuaded Argentina to eliminate its restrictions. However, it replaced the restrictions with a discriminatory tax on international courier operations, which our industry maintains bore no reasonable relationship to the cost of any services provided. Recently the Argentine Government allegedly has harassed the local franchise of one U.S. company, DHL, on the basis of purported ties to British interests. In addition, the Government is replacing the clearly discriminatory tax system with a nondiscriminatory tax system that may operate nonetheless to the disadvantage of international couriers and to the advantage

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of the Argentine monopoly postal authority, ENCOTEL.

The Section 301 Committee will review the new draft regulations as soon as they are available and meet with U.S. industry representatives and GOA officials. If the Committee concludes that the Argentine Government simply would be replacing one unfair and burdensome practice with another, it will recommend any appropriate action to the Trade Policy Review Group.

Brazil Informatics

President Reagan suspended the procedural and market reserve portions of this case in December 1986, and the intellectual property portion on July 1. The latter suspension was based on passage by Brazil's Chamber of Deputies of legislation that would provide adequate copyright protection to computer software. However, Brazil's Senate does not consider this legislation urgent and may delay its consideration until it completes drafting the Constitution. More ominously, the Brazilian private sector opposes the bill's market reserve provisions for software, which prohibit software imports if a Brazilian company produces a "functional equivalent." Brazilian software user and producer associations have asked the Senate leadership to replace this provision with a tax on imported programs. If the Senate amends the bill, it will be sent back to the Chamber of Deputies, where nationalistic deputies are likely to try to derail the entire bill if they believe that the market reserve policy is threatened.

To further complicate matters, Brazil's Secretariat for Informatics may shortly approve a pending license application for a Brazilian clone of the Apple MacIntosh 512 personal computer. Depending upon these developments, the EPC may have to consider whether to reopen the intellectual property portion of this case. (The investment portion remains active.)

Other Current Section 301 Cases

The following are major developments and deadlines in other active Section 301 cases:

- o Canada Fish (concerning Canadian prohibitions on the export from Canada of unprocessed salmon and herring): We expect the GATT panel report in October. The deadline for the Trade Representative's recommendations to the President is 30 days following the conclusion of dispute settlement.

- o India Almonds (concerning Indian licensing requirements and steep tariffs on imports of almonds): At the Indian Government's request, a second round of GATT consultations is scheduled for the week of September 28; and we have asked for the establishment of a panel in the Licensing Code Committee. The deadline for the Trade Representative's recommendations to the President is 30 days following the conclusion of dispute settlement.

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o Brazil Pharmaceuticals (concerning Brazil's lack of product or process patent protection for pharmaceutical products): After three rounds of consultations, the Brazilian Government indicated it would not grant either product or process patent protection for pharmaceuticals. Public hearings are scheduled for September 14. The deadline for the Trade Representative's recommendations to the President is July 23, 1988.

Possible Section 301 Industry Petitions in the Wings

In addition to pending cases, we are aware of the following petitions that could be filed by U.S. industry:

o Canada wine (concerning provincial barriers to the sale of U.S. wine in Canada): The Wine Institute submitted a draft petition this summer, and is likely to file if FTA negotiations do not resolve this trade barrier.

o Canada printing (concerning various Canadian barriers to the importation of certain U.S. printed publications): Printing Industries of America, Inc. submitted a draft petition late last spring, apparently intended to serve as leverage in the FTA negotiations.

o UK/FRG/France/Spain Airbus (concerning subsidies and inducements to the purchase of Airbus aircraft): Boeing and McDonnell Douglas continue to consider the possibility of petitions under section 301 and/or the antidumping and countervailing duty laws.

o EC Soybeans (concerning the EC's domestic subsidies for soybeans): The American Soybean Association has submitted a second draft petition which the Section 301 Committee is reviewing. ASA says it plans to file September 16, and is determined to proceed regardless of agency comments. This would be a blockbuster case. In 1986 U.S. oilseed and oilseed product exports to the EC totaled \$2.3 billion, compared to \$4.2 billion five years ago. If filed and initiated, it presumably would be handled as a GATT case; therefore, the deadline for the Trade Representative's recommendations to the President would be 30 days following the conclusion of dispute settlement.

o Argentina/Chile Pharmaceuticals (concerning those countries' lack of product patent protection for pharmaceuticals): The Pharmaceutical Manufacturers Association (petitioner in the Brazil case) advises us that they plan to file petitions on Argentina and Chile as well in November.

Another Possible Self-Initiation Candidate

Finally, at some point agencies may be called upon to review

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again Japanese soda ash practices. Several times we have considered whether to self-initiate an investigation based upon possible cartel activities among Japanese firms tolerated by the Government, and U.S. soda ash producers' failure to sell as much soda ash in Japan as their comparative advantage would warrant. Senators Wallop and Symms have urged us repeatedly to consider action under section 301.

To date, however, the Justice Department and some other agencies have opposed this step based upon insufficient evidence of the continuation or resumption of an earlier cartel. The Section 301 Committee is monitoring this situation, and will recommend action to the Trade Policy Review Group if evidence of unfair and burdensome practices by the Japanese Government develops.

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DEPUTY UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON, D.C. 20506
202-395-5114

September 10, 1987

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: THE TRADE POLICY REVIEW GROUP

SUBJECT: SECTION 301 ACTION AGAINST KOREAN INSURANCE PRACTICES
ISSUE

Should the President determine under section 301 that Korean practices involving access to its life insurance market are unfair and direct the development of appropriate and feasible counteraction.

RECOMMENDATION

There is consensus in the TPRG that the attached section 301 unfairness determination should be forwarded to the President for his signature. USTR will continue to seek a satisfactory solution through negotiations simultaneously with the implementation of the unfairness determination.

THE 1986 SECTION 301 AGREEMENT

o Last year we concluded a self-initiated section 301 action against Korean insurance practices intended to provide full market access to that market for U.S. companies. The 1986 agreement (attached) specified that qualified U.S. insurance firms would be promptly licensed. No reference was made to the form of establishment -- branch office, subsidiary or joint venture -- under which U.S. insurance firms would be required to operate in either the life or non-life insurance markets.

o The United States government consistently maintained its position that restrictions on the form of establishment for entry into the Korean insurance market were unacceptable. During April trade consultations and the July Economic Consultations, the Koreans were put on notice that failure to allow joint ventures and subsidiaries in the life market would be viewed by the United States as a derogation of the agreement.

REMAINING MARKET ACCESS BARRIERS

o Implementation of the agreement to date has produced mixed results. U.S. firms have been admitted to the compulsory fire

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pool, two limited life licenses have been approved and numerous procedural/regulatory issues have been resolved. However, we have not achieved the objective of full market access to the life insurance market as a result of Korean limitations on participation in that segment of the market to branch offices.

LEGAL BASIS FOR ACTION

- o Ambiguity in the language of the 1986 agreement makes it difficult to assert unequivocally that Korea has violated the agreement. Nonetheless, Korea's pattern of interpreting and implementing the agreement in an unduly narrow manner has prevented U.S. firms from gaining full entry to the life market.
- o The August 18, 1987 Korean decision to reject a bona fide joint venture application, as well as its stated intent to reject future joint venture applications and applications of U.S. subsidiaries, clearly signal the Korean policy of continued protection of its life insurance market. Other practices -- such as delays in the issuance of licenses, limitations on the number of products that U.S. insurance firms may market and requirements concerning renewal of licenses every two years-- also underscore the Korean intention to attempt to implement the 1986 agreement in a minimalist fashion.
- o It is the consensus of the TPSC Korea Subcommittee responsible for monitoring implementation of the 1986 section 301 agreement that further technical level consultations under the consultative mechanism of the agreement will not accomplish the goal of increased access for U.S. firms. Elimination of restrictions on form of establishment would require a ministerial level decision in Seoul. Such a decision is unlikely in the absence of an unfairness determination and a direction to recommend counter-measures.
- o Because these practices deny national treatment and fair and equitable market opportunities, they may be considered unreasonable under section 301. Because they also burden and restrict U.S. commerce (by limiting the sale of insurance by U.S. firms in Korea), they are actionable under section 301.
- o In addition, we believe these restrictions violate Article VII of the 1956 U.S.-Korea Treaty of Friendship, Commerce and Navigation. Article VII accords national treatment "with respect to engaging in all types of commercial, ... financial and other activities for gain (business activities) ..., whether directly or by agent or through the medium of any form of lawful individual entity." In our opinion, the broad scope of this provision covers insurance services. Consequently, Korean government acts, policies and practices are also unjustifiable under section 301.

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~~CONFIDENTIAL~~PRIVATE SECTOR VIEWS

o The Korean insurance market is the 10th largest in the world with 1986 total life premiums of \$6.3 billion. The life market grew at an average annual rate of 30 percent between 1982-1986. Industry analysis predicts average annual growth of 20 percent in the Korean life market over the next five years. Again according to industry analysis, roughly five years of operation by new entrants to the market are required before profits are earned. The International Insurance Council estimated in 1986 that U.S. firms would be able to capture immediately a 5 percent market share if allowed to operate without restriction on form of establishment. We believe this is a conservative estimate given the industry's interest in pursuing entry into the Korean market following the 301 agreement, i.e., letters of intent or applications from six U.S. firms.

o U.S. insurance firms have actively supported our efforts to aggressively enforce the 1986 section 301 agreement. Preliminary soundings of the industry indicate that it will support retaliation.

POSSIBLE RETALIATION

o Based on industry analysis, we estimate that the 1986-90 Korean life market will approximate \$55 billion in total premiums. Using an average annual premium level of \$11.3 billion, we estimate that U.S. firms are losing in the range of \$550 million to \$1.1 billion in life premiums annually.

o Preliminary interagency discussions have focused on developing a retaliation package based on imposing prohibitive tariffs on Korean exports in the \$0.5 to \$1.0 billion range (1986 Korean exports to the U.S. were valued at \$13.4 billion).

o It is generally agreed that textiles covered by the bilateral agreement and steel items under restraint should be excluded from any retaliation package. Products appropriate for consideration would include, inter alia, automobiles, various consumer electronics, computers, certain footwear, automobile tires, and processed agricultural products.

~~CONFIDENTIAL~~Classified by: *Peter Allgeier*Declassify on: *O. A. D. R*

MEMORANDUM FOR THE UNITED STATES TRADE REPRESENTATIVE

SUBJECT: Determination Under Section 301 of the Trade Act of 1974

Last year the Governments of the United States and the Republic of Korea (Korea) concluded an agreement intended to provide fair and equitable access for U.S. insurance companies to the Korean life and non-life insurance markets. However, the operation of this agreement to date has failed to achieve its objective, because Korea has engaged in unjustifiable, unreasonable or discriminatory acts that burden or restrict United States commerce. Therefore, I direct the United States Trade Representative (Trade Representative) to recommend appropriate and feasible countermeasures for my consideration unless he is able to resolve this dispute through bilateral agreement.

Reasons for Determination

On September 16, 1985, at my direction, the Trade Representative initiated an investigation under section 302(c) of the Trade Act of 1974, as amended (the Act), of the Korean Government's policy of prohibiting or restricting the activities in Korea of foreign insurance firms.

On August 14, 1986, I determined that certain acts, policies or practices of Korea regarding access to its insurance markets were unjustifiable, unreasonable or discriminatory and a burden or restriction on United States commerce. Specifically, I addressed the Korean Government's policy of prohibiting or restricting U.S. firms from participating fully in Korea's compulsory fire insurance, life insurance and reinsurance markets.

However, the Governments of the United States and Korea concluded an agreement that appeared to resolve the lack of access by U.S. firms to the Korean insurance markets. Also on August 14, 1986, I determined to accept that agreement and terminate the investigation. I also directed the Trade Representative to take any actions necessary to implement and monitor the agreement. I stated my expectation that this agreement would accomplish our goal of obtaining increased access for U.S. firms to Korea's insurance markets.

Unfortunately, we have not achieved this goal. The Government of Korea has interpreted the agreement unduly narrowly. For example, it has refused to permit joint ventures of American and Korean companies to offer insurance services, and has failed to act promptly on applications by U.S. insurance firms for licenses. Moreover, it has repeatedly refused to modify its restrictive policies and practices in this regard despite U.S. resort to the consultative mechanism established in the agreement.

Therefore, I have determined that further acts, policies and practices of the Government of Korea regarding access to its

insurance markets are unjustifiable, unreasonable or discriminatory and a burden or restriction on United States commerce. I am directing the Trade Representative to initiate a new proceeding under section 302(c). If he is unable to achieve fair and equitable access to Korea's insurance markets through a mutually satisfactory bilateral resolution of this matter, I direct him to recommend appropriate and feasible countermeasures.

THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON
20506

August 28, 1986

The Honorable Kyung-Won Kim
Embassy of the Republic of Korea
2370 Massachusetts Avenue, N.W.
Washington, D.C. 20008

Dear Ambassador Kim:

I have the honor to acknowledge receipt of your letter of today's date which reads as follows:

"Dear Ambassador Yeutter:

This letter sets forth measures that the Government of the Republic of Korea (ROKG) will undertake in connection with insurance practices.

A. NON-LIFE INSURANCE

1. The ROKG will license two U.S. firms to underwrite compulsory fire insurance and will assist the two U.S. firms to become admitted to the fire pool in all geographic areas by July 31, 1986.
2. The allocation of premia and risks within the fire pool is not subject to government regulation or control, but is a matter of private agreement. Accordingly, the method of allocating premia and risks within the fire pool will be negotiated and decided upon by the participating firms, including participating U.S. firms. The ROKG will provide support for a fair and reasonable system of allocation of premia within the fire pool. In this regard, it is understood that U.S. firms will participate in the fire pool on the basis of the same allocation formula that applies to Korean firms participating in the pool. This principle would permit the U.S. firms, under the current allocation formula, to share equally in premia distribution within the pool. Subsequent to the date of this letter, the U.S. firms referred to in the above paragraph will participate fully in any reformulation of the distribution of premia. It is understood that any change in the current formula would be through agreement among all the insurance firms participating in the pool including the two U.S. firms referred to in the above paragraph. It is understood that the U.S. firms operating in the pool will not share risks and participate in the allocation of premia for

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the buildings owned by the government or defense contractors. It is further understood that the proportional share of underwriting activity in the fire pool represented by the buildings owned by the government or defense contractors will not change significantly. Should either government so request, the two governments shall consult in the consultative mechanism concerning this issue.

B. LIFE INSURANCE

The ROKG will license at least one branch of a U.S. insurance firm to underwrite life insurance by the end of 1986.

C. ADDITIONAL LICENSES

The ROKG will license qualified U.S. insurance firms to underwrite life and non-life insurance in Korea. Korean insurance authorities will be prepared to receive license applications as soon as the section 301 case is terminated, and will provide all necessary information as to the technical requirements for submitting applications. All applications will be reviewed in a timely fashion and decisions rendered on the qualifications of U.S. firms will be provided in writing.

D. CONSULTATIVE MECHANISM

The ROKG and the United States government agree to consult through the Korea-U.S. Economic Consultation Trade Subgroup regarding (1) any matters relating to the implementation of the understanding reached with respect to the 301 case on insurance (e.g., complaints about specific practices, the operation of the fire pool, technical and administrative matters and new entrants to the market) and (2) other issues on insurance of interest to either party. Consultations in the Trade Subgroup concerning regulatory and capitalization requirements, reinsurance and retention levels will begin in August 1986 and proceed according to a schedule to be developed by the two governments with a view to reaching specific understandings during 1986.

It is our understanding that, in recognition of these measures, the United States Government has terminated the investigation into insurance practice in Korea initiated under section 301 of the Trade Act of 1974, as amended.

Sincerely,

Kyung-Won Kim
Ambassador"

- 3 -

Based on the commitments contained in your letter, and in anticipation that implementation of these commitments will proceed as scheduled, the United States Government has terminated the investigation into insurance practices in Korea initiated under section 302(c) of the Trade Act of 1974, as amended.

Sincerely,



Clayton Yeutter

~~CONFIDENTIAL~~

September 3, 1987

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: THE TRADE POLICY REVIEW GROUP

SUBJECT: SECTION 301 DEVELOPMENTS

Summary

This memorandum outlines likely section 301 developments between now and year's end. The Economic Policy Council may wish to take them into account in deciding whether to initiate investigations or recommend action under section 301 to the President regarding telecommunications, Korean insurance, and Japan Kansai practices.

EC Meat Issues

Third Country Meat Directive. On May 1, 1987, the EC began implementing its Third Country Meat Directive, which precludes the importation of meat products from any plant outside the EC that does not pass EC inspection. The directive establishes detailed requirements, such as:

- o the maintenance of separate rooms for various meat slaughter and processing operations, and
- o a prohibition on the use of wooden pallets, knife handles, structural beams or fencing.

Of the more than 400 U.S. plants inspected by the EC since 1984, only 7 slaughter and 3 cutting plants have been certified. Another 59 slaughter plants are approved only until December 31, 1987, and must be reinspected by EC officials.

In 1986, U.S. meat exports (beef, veal, pork, horse and variety meats) to the EC exceeded \$165 million in value, or about 15 percent of total U.S. meat exports that year. USDA currently accepts meat imports from over 250 European plants.

Last year we undertook a fact-finding investigation under section 305 of the Trade Act of 1974 on our own motion. The EC offered to cooperate but never responded to the questions we posed.

On July 22, Ambassador Yeutter initiated a section 301 investigation in response to a petition filed by the American Meat Institute,

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U.S. Meat Export Federation, National Pork Producers Council, American Farm Bureau Federation and National Cattlemen's Association. They charge that the directive denies national treatment (because its standards are not enforced in trade between EC member states, and do not apply within member states), and cannot be justified on the basis of scientific evidence. Because these issues arise under the GATT and Standards Code, we requested consultations under Article 23:1, which are scheduled this month.

However, we have no realistic hope of achieving an outcome under GATT dispute settlement procedures by January 1, when the temporary approvals of 59 U.S. plants expire. Unless they are certified, the result will be either a reduction in U.S. meat exports to the EC, or the incurrence of unnecessary expenditures by U.S. plants to conform to EC requirements.

EC Hormones. In January 1987, the U.S. asked for consultations under the Standards Code to complain of the EC's Animal Hormone Directive. This directive precludes the importation into the EC after January 1, 1988, of any meat produced from animals treated with hormones (which is widespread in the U.S.). We believe that hormones can be used safely under prescribed conditions, and that the EC should accept our residue testing program as a sufficient guarantee of the safety of meat from animals treated with hormones.

After the Standards Code Committee was unable to achieve a mutually satisfactory solution, in July 1987 the U.S. asked for the establishment of a technical experts group. The EC has blocked its establishment, interrupting the dispute settlement process. Unless the EC agrees soon to proceed, we may wish to consider self-initiating an investigation or acting under section 301. Even if the EC permits dispute settlement to proceed, however, it could not be completed prior to the implementation January 1 of the EC directive.

As a result of the Third Country Meat and Animal Hormone Directives, as of January 1, 1988, we expect U.S. exports of meat products to the EC to cease abruptly. The issue for the EPC will be whether and how to act unilaterally absent a satisfactory resolution in the interim. This issue must be addressed no later than early November, if public comment on proposed retaliatory measures were to be obtained and retaliation implemented by January 1.

Argentina Soybeans

The Government of Argentina has maintained higher export taxes on soybeans than on processed soybean products. This differential discourages the exportation of beans, puts downward pressure on the price of soybeans in Argentina, and thus provides a competitive advantage to the Argentine crushers of soybeans into soybean meal and oil.

In response to a petition filed by the National Soybean Processors Association in 1986, we initiated a section 301 investigation.

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Last May, the President suspended this investigation based upon the Argentine Government's commitment to eliminate or substantially reduce all export taxes by October 15.

On July 20 Argentina eliminated or significantly reduced the export taxes on all products except soybeans and sunflower seeds. It reduced the differential in taxes on soybeans and processed soybean products from 12 to 11 percent, which we do not consider a substantial reduction.

We are pressing the Argentine Government to fulfill its pledge by October 15. Argentina's Finance Minister will meet with Ambassador Yeutter at the end of September to discuss the problem. However, for Argentine domestic political and revenue reasons, we are skeptical how far the Government will move.

Agencies agree that this export tax differential distorts trade; despite repeated deliberations within the Section 301 Committee, they still disagree whether it is unjustifiable, unreasonable or discriminatory and a burden or restriction on U.S. commerce (the criteria of section 301). However, breach of Argentina's commitment to eliminate or substantially reduce all export taxes by October 15 would be independently actionable under section 301 as unjustifiable, if it also burdened or restricted U.S. commerce.

Absent a satisfactory settlement by October 15, the issue for the EPC will be whether and how to respond to Argentina's breach of its commitment and maintenance of an export tax differential that distorts trade. This issue would arise as of October 15, but there would be no need to act immediately to preserve the status quo (as in the EC meat matters).

Argentina Air Couriers

In 1984 the Air Courier Conference of America complained of the Argentine Government's restrictions on the delivery of time-sensitive commercial documents, which essentially prohibited U.S. couriers from the international carriage of such items. In November 1984 the President determined this practice to be unreasonable and a restriction on U.S. commerce. He directed the Trade Representative to consult further with Argentina, but to submit proposals for action under section 301 within 30 days if the issue were not resolved through consultations.

With the help of this leverage, we persuaded Argentina to eliminate its restrictions. However, it replaced the restrictions with a discriminatory tax on international courier operations, which our industry maintains bore no reasonable relationship to the cost of any services provided. Recently the Argentine Government allegedly has harassed the local franchise of one U.S. company, DHL, on the basis of purported ties to British interests. In addition, the Government is replacing the clearly discriminatory tax system with a nondiscriminatory tax system that may operate nonetheless to the disadvantage of international couriers and to the advantage

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of the Argentine monopoly postal authority, ENCOTEL.

The Section 301 Committee will review the new draft regulations as soon as they are available and meet with U.S. industry representatives and GOA officials. If the Committee concludes that the Argentine Government simply would be replacing one unfair and burdensome practice with another, it will recommend any appropriate action to the Trade Policy Review Group.

Brazil Informatics

President Reagan suspended the procedural and market reserve portions of this case in December 1986, and the intellectual property portion on July 1. The latter suspension was based on passage by Brazil's Chamber of Deputies of legislation that would provide adequate copyright protection to computer software. However, Brazil's Senate does not consider this legislation urgent and may delay its consideration until it completes drafting the Constitution. More ominously, the Brazilian private sector opposes the bill's market reserve provisions for software, which prohibit software imports if a Brazilian company produces a "functional equivalent." Brazilian software user and producer associations have asked the Senate leadership to replace this provision with a tax on imported programs. If the Senate amends the bill, it will be sent back to the Chamber of Deputies, where nationalistic deputies are likely to try to derail the entire bill if they believe that the market reserve policy is threatened.

To further complicate matters, Brazil's Secretariat for Informatics may shortly approve a pending license application for a Brazilian clone of the Apple MacIntosh 512 personal computer. Depending upon these developments, the EPC may have to consider whether to reopen the intellectual property portion of this case. (The investment portion remains active.)

Other Current Section 301 Cases

The following are major developments and deadlines in other active Section 301 cases:

- o Canada Fish (concerning Canadian prohibitions on the export from Canada of unprocessed salmon and herring): We expect the GATT panel report in October. The deadline for the Trade Representative's recommendations to the President is 30 days following the conclusion of dispute settlement.

- o India Almonds (concerning Indian licensing requirements and steep tariffs on imports of almonds): At the Indian Government's request, a second round of GATT consultations is scheduled for the week of September 28; and we have asked for the establishment of a panel in the Licensing Code Committee. The deadline for the Trade Representative's recommendations to the President is 30 days following the conclusion of dispute settlement.

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o Brazil Pharmaceuticals (concerning Brazil's lack of product or process patent protection for pharmaceutical products): After three rounds of consultations, the Brazilian Government indicated it would not grant either product or process patent protection for pharmaceuticals. Public hearings are scheduled for September 14. The deadline for the Trade Representative's recommendations to the President is July 23, 1988.

Possible Section 301 Industry Petitions in the Wings

In addition to pending cases, we are aware of the following petitions that could be filed by U.S. industry:

o Canada wine (concerning provincial barriers to the sale of U.S. wine in Canada): The Wine Institute submitted a draft petition this summer, and is likely to file if FTA negotiations do not resolve this trade barrier.

o Canada printing (concerning various Canadian barriers to the importation of certain U.S. printed publications): Printing Industries of America, Inc. submitted a draft petition late last spring, apparently intended to serve as leverage in the FTA negotiations.

o UK/FRG/France/Spain Airbus (concerning subsidies and inducements to the purchase of Airbus aircraft): Boeing and McDonnell Douglas continue to consider the possibility of petitions under section 301 and/or the antidumping and countervailing duty laws.

o EC Soybeans (concerning the EC's domestic subsidies for soybeans): The American Soybean Association has submitted a second draft petition which the Section 301 Committee is reviewing. ASA says it plans to file September 16, and is determined to proceed regardless of agency comments. This would be a blockbuster case. In 1986 U.S. oilseed and oilseed product exports to the EC totaled \$2.3 billion, compared to \$4.2 billion five years ago. If filed and initiated, it presumably would be handled as a GATT case; therefore, the deadline for the Trade Representative's recommendations to the President would be 30 days following the conclusion of dispute settlement.

o Argentina/Chile Pharmaceuticals (concerning those countries' lack of product patent protection for pharmaceuticals): The Pharmaceutical Manufacturers Association (petitioner in the Brazil case) advises us that they plan to file petitions on Argentina and Chile as well in November.

Another Possible Self-Initiation Candidate

Finally, at some point agencies may be called upon to review

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again Japanese soda ash practices. Several times we have considered whether to self-initiate an investigation based upon possible cartel activities among Japanese firms tolerated by the Government, and U.S. soda ash producers' failure to sell as much soda ash in Japan as their comparative advantage would warrant. Senators Wallop and Symms have urged us repeatedly to consider action under section 301.

To date, however, the Justice Department and some other agencies have opposed this step based upon insufficient evidence of the continuation or resumption of an earlier cartel. The Section 301 Committee is monitoring this situation, and will recommend action to the Trade Policy Review Group if evidence of unfair and burdensome practices by the Japanese Government develops.

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